Chapter 3

Financial resources for Securities and Futures Firms which are not MiFID Investment Firms

3-A R

The definitions in the glossary at Appendix 1 apply to this chapter.

3-1 R

This chapter applies to a securities and futures firm which is not a MiFID investment firm.

3-1 G

[deleted]

3-1A R

This chapter does not apply to an oil market participant unless it is a member of a recognised or designated investment exchange which is, under the rules of that exchange, entitled to trade with other members.

3-1 A G

An oil market participant to which this chapter does not apply is still subject to the requirement of Principle 4 to have adequate financial resources.

3-1 B R

The provisions on concentrated risk in this chapter:

(a) apply to an exempt BIPRU commodities firm if it satisfies the conditions in BIPRU TP 16 (Commodities firm transitionals: large exposures) in the version as at 31 December 2013; and
(b) do not apply to an exempt IFPRU commodities firm which applies the large exposure requirements Part Four (articles 387 to 403) of the EU CRR.

3-1B G

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3-1 C G

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3-1 D G

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3-2 R

A firm must at all times have available the amount and type of financial resources required by the rules of the FCA.

3-5 R

A firm must notify the FCA immediately it becomes aware that it is in breach of, or that it expects shortly to be in breach of, rule 3-2.

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

3-41(9) R

A firm must value a position on a prudent and consistent basis, as well as having regard to the liquidity of the instrument concerned and any special factors which may adversely affect the closure of the position, and must adopt the following general policies:

(a) a position must be valued at its close out price (close out price means that a long position shall be valued at current bid price and a short position at current offer price); where firm two way prices are not available a firm must value its position in accordance with the notes to this rule;*

(b) where a firm is entitled to use a risk assessment model in the calculation of its PRR on options positions, it may value its options using the values derived from the model;

(c) where a firm does not use a model as described in (b) above and prices are not published for its options positions, a firm must determine the mark to market value as follows:

  (i) for purchased options, the mark to market value must be the product of:

    (aa) the in the money amount; and
    (bb) the quantity underlying the option;

  (ii) for written options the mark to market value must be the initial premium received for the option plus the product of:

    (aa) the amount by which the current in the money amount exceeds either the in the money amount at the time the contract was written, or zero if the contract was out of the money at the time it was written; and
    (bb) the quantity underlying the option;

(d) a firm must calculate the value of a swap contract or an FRA having regard to the net present value of the future cash flows of the contract, using current interest rates relevant to the periods in which the cash flows will arise;

(e) notwithstanding (d) above, a firm may refrain from marking a swap or an FRA to market where it enters into such transactions on a matched principal basis, provided that it is confident that such positions are fully matched;

(f) a firm that is a partnership which experiences exceptional administrative or technical difficulties complying with the valuation procedure outlined above should notify the FCA immediately; and

(g) in the case of interest rate swaps, currency swaps and FRAs, a firm may limit the bid/offer valuation required under (a) to its net position.

3-41(9) G

The FCA does not lay down a precise formula for calculating the value of swaps and FRAs for the purposes of this rule. However, it will expect a firm to employ a valuation formula which accords with generally accepted market practice.

The FCA may permit by modification or waiver of this rule an alternative arrangement if it is satisfied that neither the firm nor its counterparties will be put at risk by the adoption of that alternative procedure.

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

Broad scope firms

3-60(1) R

Rules 3-61 to 3-182 apply to a broad scope firm except that rules 3-80 to 3-178 do not apply to a venture capital firm or in respect of bidding in emissions auctions carried on by a firm that is an exempt MiFID commodities firm.

Arrangers

3-60(2) R

Rules 3-61 to 3-182 apply to an arranger, except that:

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

Corporate finance advisory firms

3-60(3) R

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

(a) tangible net worth must exceed £10,000; and
(b) net current assets must exceed £10,000.

3-60(3A) R

(a) Net current assets for the purposes of rule 3-60(13)R(b) shall be as calculated for the purposes of producing a balance sheet in accordance with the following provisions, as applicable:

(i) Format 1 of the Balance Sheet Format of Schedule 4 to the Companies Act 1985; or
(ii) Schedule 1 to the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409); or
(ii) Schedule 1 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410); or
(iv) Schedule 1 to the Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912); or
(v) Schedule 1 to the Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1913).

Advisers

3-60(4) R

Rules 3-61 to 3-182 do not apply to an adviser which must instead comply with the following capital requirements at all times:

(a) tangible net worth must be positive; and
(b) net current assets must be positive.

3-60(4A) R

(a) Net current assets for the purposes of rule 3-60(4)R(b) shall be as calculated for the purposes of producing a balance sheet in accordance with the following provisions as applicable:

(i) Format 1 of the Balance Sheet Format of Schedule 4 to the Companies Act 1985; or
(ii) Schedule 1 to the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409); or
(iii) Schedule 1 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410); or
(iv) Schedule 1 to the Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912); or
(v) Schedule 1 to the Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1913).

Derivative fund managers

3-60(5) R

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

(a) tangible net worth must exceed £10,000; and
(b) net current assets, excluding investment in any pooled fund or unregulated collective investment scheme which it manages, must exceed £10,000.

3-60(5A) R

(a) Net current assets for the purposes of rule 3-60(5)R(b) shall be as calculated for the purposes of producing a balance sheet in accordance with the following provisions as applicable:

(i) Format 1 of the Balance Sheet Format of Schedule 4 to the Companies Act 1985; or
(ii) Schedule 1 to the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409); or
(iii) Schedule 1 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410); or

(iv) Schedule 1 to the Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912); or
(v) Schedule 1 to the Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1913).

Dematerialised instruction transmitters

3-60(6) R

Rules 3-61 to 3-182 apply to a dematerialised instruction transmitter.

3-60(7) R

(a) Subject to (b), rules 3-61 to 3-182 apply to a firm whose permission includes establishing, operating or winding-up a personal pension scheme.
(b) In addition, a firm to which (a) applies, must have and maintain at all times financial resources calculated in accordance with the applicable rules in Chapter 5 at least equal to the relevant requirement set out in that chapter.

3-60(8) R

[deleted]

3-60(9) G

[deleted]

3-60(10) G

[deleted]

3-61 THE BASIC COMPUTATION

3-61(1) R

A firm must, at all times, maintain financial resources in excess of its financial resources requirement.

3-61(2) R

A firm must calculate its financial resources and its financial resources requirement in accordance with the table below and rules 3- 62 to 3-182.

Table 3-61. The basic financial resources calculation

Financial resources	
Capital ("A") the sum of – - ordinary share capital - preference share capital - share premium account - profit and loss account - other approved reserves - partners' current and capital - accounts, and - eligible LLP members' capital Deductions ("B") the sum of – - Intangible assets, and - Excess LLP members' drawings A – B = tangible net worth ("C")	Primary requirement ("E") the sum of – - base requirement - total liquidity adjustment, which is the sum of: • tangible fixed assets (in accordance with IPRU(INV) 3-75(3)R) • land and buildings used as security for nonrecourse loans (in accordance with IPRU(INV) 3- 75(4)R) • land and buildings used as security for other loans (in accordance with IPRU(INV) 3-75(5)R) • physical stocks (in accordance with IPRU(INV) 3-75(6)R) • investments in connected companies (in accordance with IPRU(INV) 3-75(7)R) • pre-payments (in accordance with IPRU(INV) 3- 75(9)R) • other debtors (in accordance with IPRU(INV) 3- 75(11)R) • cash deposits (in accordance with IPRU(INV) 3- 75(12)R) • other assets (in accordance with IPRU(INV) 3- 75(13) R) - charged assets - contingent liabilities, and - deficiencies in subsidiaries
Eligible capital substitutes ("D") the sum of – - subordinated loans - approved bank bonds - approved undertakings	Total PRR ("F") Total CRR ("G")
C + D = financial resources	E + F + G = financial resources requirement

3-62 TANGIBLE NET WORTH

Calculation

3-62(1) R

A firm must calculate its tangible net worth in accordance with table 3- 61, subject to (2) to (9) below.

Redeemable shares

3-62(2) R

A firm may include redeemable share capital as part of tangible net worth only if:

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

(i) redemption may not occur if the firm's financial resources after redemption would be less than or equal to 120% of its financial resources requirement;
(ii) dividends may not be paid if the firm's financial resources after payment would be less than or equal to 120% of its financial resources requirement; and
(iii) in the case of a shareholder's agreement, any assignee of the shares is subject to the provisions of the agreement; and

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

Notice of redemption

3-62(3) R

A firm must provide the FCA with six months' written notice of redemption of any of its redeemable shares.

Approved reserves

3-62(4) R

A firm may not include reserves other than retained profits as part of tangible net worth.

3-62(4) G

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

Profit and loss account/partners' current and capital accounts

3-62(5) R

For the calculation of tangible net worth, a firm must:

(a) deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
(b) in respect of a defined benefit occupational pension scheme, derecognise any defined benefit asset.

3-62(6) R

A firm may, for the purposes of calculating tangible net worth, substitute for a defined benefit liability the firm's deficit reduction amount. The election must be applied consistently in respect of any one financial year.

3-62(7) G

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

3-62(8) R

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

Intangible assets and excess LLP members' drawings

3-62(9) R

For the calculation of tangible net worth, a firm must deduct any intangible assets and excess LLP members' drawings from capital to arrive at tangible net worth under 3-62.

3-63 ELIGIBLE CAPITAL SUBSTITUTES

Calculation

3-63(1) R

A firm must calculate its eligible capital substitutes in accordance with table 361, subject to (2) to (9) below.

Approved eligible capital substitutes

3-63(2) R

A firm may treat a subordinated loan, approved bank bond or approved undertaking as an eligible capital substitute only if it is:

(a) drawn up in accordance with the relevant standard form obtained from the FCA; and
(b) signed by authorised signatories of all the parties.

3-63(2) G

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

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

Approved lenders

3-63(3) R

A firm may treat a subordinated loan as an eligible capital substitute only if the lender is:

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

3-63(3) G

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

Notice of repayment and termination

3-63(4) R

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

Amounts repayable within three months

3-63(5) R

A firm may not treat any amount of a subordinated loan which is repayable within three months as an eligible capital substitute.

Limit on eligible capital substitutes

3-63(6) R

The total amount of eligible capital substitutes which a firm may take into account in its financial resources must not exceed four times tangible net worth.

Limit on approved bank bonds

3-63(7) R

The total of approved bank bonds which a firm may treat as an eligible capital substitute must not exceed:

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

Limit on approved undertakings

3-63(8) R

A firm may only treat approved undertakings as an eligible capital substitute to the extent that its approved bank bonds are less than 30% of its base requirement.

Approved undertakings

3-63(9) R

A firm may treat an undertaking as an eligible capital substitute only if the provider of the undertaking is:

(a) a regulated banking institution; or
(b) a regulated financial institution;

3-63(9) G

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

PRIMARY REQUIREMENT

Definition of primary requirement - General rule

3-70 R

A firm's primary requirement is the sum of:

(a) the base requirement calculated in accordance with rule 3-71;
(b) the total liquidity adjustment calculated in accordance with rule 3-75;
(c) charged assets calculated in accordance with rule 3-76;
(d) contingent liabilities calculated in accordance with rule 3-77; and
(e) deficiencies in subsidiaries calculated in accordance with rule 3-78;

Base requirement - General rule

3-71 R

A firm's base requirement is the highest of:

(a) the absolute minimum requirement, calculated in accordance with rule 3-72;
(b) the expenditure requirement, calculated in accordance with rule 3-73; or
(c) the volume of business requirement, calculated in accordance with rule 3-74.

Absolute minimum requirement – General rule

3-72 R

A firm's absolute minimum requirement is the highest of the applicable requirements in the following list:

(a) for an *arranger* to which (aa) does not apply: £10,000;
(aa) for an *arranger* with *permission* to operate an electronic system for public offers of relevant securities, in accordance with article 25DB of the Regulated Activities Order: £75,000;
(b) for a financial bookmaker: £50,000;
(c) for an agency broker: £50,000;
(d) for a firm which handles client money and assets relating to margined transactions and segregates all money received from clients as client money: £50,000;
(e) for a non clearing floor member: £50,000;
(ea) for a dematerialised instruction transmitter: £50,000;
(eb) for a firm that is an exempt MiFID commodities firm and whose permitted activities include bidding in emissions auctions: £50,000;
(f) for a broad scope firm other than one within (b) to (eb) above: £100,000; or
(g) for a *firm* with *permission* to *provide targeted support*: £500,000.

3-73 EXPENDITURE REQUIREMENT

General rule

3-73(1) R

A firm's expenditure requirement is:

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

Calculation of relevant annual expenditure

3-73(2) R

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

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

less the aggregate of the following items:

(c) profit before taxation;
(d) bonuses;
(e) profit shares and other appropriations of profit, except for fixed or guaranteed remuneration of a partner which is payable even if the firm makes a loss for the year;
(f) paid commissions shared, other than to employees, directors, half commission men or appointed representatives of the firm;
(g) fees, brokerage and other charges paid to clearing houses, exchanges, approved exchanges and intermediate brokers for the purposes of executing, registering or clearing transactions;
(h) interest payable to counterparties;
(i) interest payable on borrowings to finance the firm's investment business and associated business; and
(j) exceptional or extraordinary items, provided that it first notify the FCA in writing of the nature and amount of the item(s) concerned.

Absence of annual financial statements

3-73(3) R

If a firm does not have annual financial statements, it must:

(a) where it has just commenced trading, base its relevant annual expenditure on budgeted or other accounts which it submitted to the FCA as part of its application; or
(b) where its accounts do not represent a 12 month period, calculate relevant annual expenditure on a proportionate basis agreed by the FCA.

Adjustments to relevant annual expenditure

3-73(4) R

A firm must use a relevant annual expenditure adjusted to take account of its circumstances where:

(a) there has been a significant change in the circumstances or activities of the firm; or

(b) the firm has a material proportion of its expenditure incurred on its behalf by third parties and such expenditure is not fully recharged to the firm.

3-73(4) G

FCA would for example consider an application to vary a firm's permitted activity as a significant change.

FCA would consider 10% of a firm's expenditure incurred on its behalf by third parties to be material.

If a firm is in any doubt, it should always seek guidance from the FCA.

Recent Authorisation

3-73(5) R

If a firm has not been authorised long enough to have prepared annual financial statements after authorisation, it must base its relevant annual expenditure on budgeted or other accounts which it submitted to the FCA as part of its application.

Application

3-74(1) R

The volume of business requirement applies only to a firm which settles margined transactions for counterparties.

Margined transactions

3-74(2) R

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

Initial margin

3-74(3) R

A counterparty's initial margin for the purposes of (2) above is the sum of the following amounts:

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

3-75 LIQUIDITY ADJUSTMENT

General rule

3-75(1) R

A firm's total liquidity adjustment is the sum of amounts specified as liquidity adjustments below.

Intangible assets

3-75(2) R

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

Tangible fixed assets

3-75(3) R

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

Land and buildings used as security for non recourse loans

3-75(4) R

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

Land and buildings used as security for other loans

3-75(5) R

The liquidity adjustment for land or buildings used as security for loans other than non recourse loans is the difference between the net book value of the land or building and the lower of:

(a) 85% of a professional valuation of the land and buildings (which must have been carried out in the last two years); or
(b) the principal outstanding,

except where both (a) and (b) are higher than the net book value in which case there is no liquidity adjustment.

Physical stocks

3-75(6) R

The liquidity adjustment for physical stocks is the balance sheet value of such stocks, except for stock positions associated with the firm's investment business which are:

(a) physical commodities for which the full contract price has been paid;
(b) work in progress and finished goods which result from the processing of physical commodities; or

(c) raw materials which will be combined with physical commodities to produce a finished processed commodity, in which case there is no liquidity adjustment (but see PRR rules).

Investments in connected companies

3-75(7) R

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

Other investments

3-75(8) R

Other investments have no liquidity adjustment but instead are subject to the PRR rules.

Prepayments

3-75(9) R

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

Debtors arising from investment business or dealing activities

3-75(10) R

Debtors arising from investment business or dealing activities have no liquidity adjustment but instead are subject to the CRR rules.

Other debtors

3-75(11) R

The liquidity adjustment for debtors other than debtors arising from investment business or dealing activities is the balance sheet value of the debtor, except that there is no liquidity adjustment in the following circumstances:

(a) amounts due from connected companies which are adequately secured and are repayable within 90 days;
(b) unsecured amounts due at the request of the firm from a connected company which is a regulated banking institution within 90 days;
(c) unsecured amounts due at the request of the firm from a connected company which is a regulated financial institution within seven days;
(d) having given prior written notice to the FCA, unsecured amounts receivable at the request of the firm from a connected company within seven days under an approved treasury arrangement, up to a maximum of the firm's excess of financial resources over

its financial resources requirement before taking into account the approved treasury arrangement;

(e) amounts receivable in respect of cash dividends declared by either exchange traded companies or authorised persons which have been outstanding for 30 days or less from the date the dividends were due to be paid;

(f) amounts accrued or receivable in respect of interest on marketable investments which have been outstanding for 30 days or less from the date the interest was due to be paid;

(g) amounts receivable on U.K. value added tax which have been outstanding for 30 days or less from the date that the value added tax return was due to be received by HM Customs & Excise; and

(h) amounts receivable on taxation other than U.K. value added tax which have been agreed with the appropriate tax authorities and have been outstanding for 30 days or less from the date that the amounts were due to be received.

Cash deposits

3-75(12) R

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

Other assets

3-75(13) R

The liquidity adjustment for assets other than those specifically stated above is the balance sheet value of the asset concerned. Other assets do not include a defined benefit asset or a deferred acquisition cost asset.

Charged assets - General rule

3-76 R

A firm must calculate the primary requirement for charged assets as the aggregate balance sheet value of each asset of the firm over which a third party has the right of sale or retention on default by the firm except:

(a) to the extent of any liability of the firm plus a reasonable margin in respect of the charged asset; or

(b) where the asset is collateral for a transaction which is subject to the CRR rules.

Contingent liabilities - General rule

3-77 R

A firm must calculate a primary requirement for each of its contingent liabilities.

Deficiencies in subsidiaries - General rule

3-78 R

A firm must calculate the primary requirement for deficiencies in subsidiaries as an amount equal to any deficiency in shareholders' funds at any time of a subsidiary of the firm except to the extent that:

(a) provision has already been made by the firm; or
(b) the firm has already calculated a liquidity adjustment or CRR because the deficiency arises or partially arises out of a liability of the subsidiary to the firm.

SECONDARY REQUIREMENT

Risk Profile

3-79(1) R

A firm must include in its secondary requirement any amount specified in any requirement to cover an unusual risk profile

Operational risks

3-79(2) R

A firm must include in its secondary requirement any amount specified in any requirement to cover the inadequate management of operational risk to which a firm is exposed.

3-79(2) G

In assessing whether to impose a requirement on a firm to cover an unusual risk profile or operational risks, the FCA will consider various criteria. In addition, the FCA will take into account material group risks to a firm, where these have not been captured in a group financial resources test. Secondary requirements may be applied, for example, where there has been a major failure on the part of a firm to maintain adequate controls, as a means of providing an additional capital buffer whilst these problems are addressed.

POSITION RISK REQUIREMENT

3-80 GENERAL PRINCIPLES OF PRR

Application

3-80(1) R

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

Obligation to calculate PRR*

3-80(2) R

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

3-80(2) G

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

Frequency of calculation

3-80(3) R

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

Marking to market

3-80(4) R

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

3-80(4A) R

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

Non marketable investments

3-80(5) R

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

Instruments for which no percentage risk addition has been specified

3-80(6) R

A firm must calculate the PRR for any on or off balance sheet position in a marketable investment for which no percentage risk addition is specified under the PRR rules as an appropriate percentage of the current mark to market value of any position or notional position underlying the contract and must notify the FCA of the terms of the instrument and the proposed PRR treatment.

3-80(6A) E

(1) In 3-80(6) "an appropriate percentage" is:

(a) 100%; or
(b) A percentage which takes account of the characteristics of the instrument concerned and of discussions with the FCA or a predecessor regulator;

(2) Compliance with (1) may be relied on as tending to establish compliance with 3-80(6).
(3) Contravention of (1) may be relied on as tending to establish contravention of 3-80(6).

Group hedging arrangements

3-80(7) R

A firm may amend its PRR to take account of a group hedging arrangement to which the firm is party, provided the group hedging arrangement is recorded by an agreement in writing between all the relevant parties and the firm first notifies the FCA in writing of the terms of the arrangement and of the proposed amendment to the PRR.

Alternative treatments

3-80(8) R

Where a firm has the alternative of treating a position under two or more different methods or treatments within methods, it must treat the position under one of those methods.

Simpler approach to PRR calculation

3-80(9) R

As a simpler approach to calculating PRR, a firm may calculate the total PRR by multiplying all positions in marketable investments by the relevant percentage stated in the table below and summing the results.

TABLE 3-80(9)

Position risk requirement - simpler approach

C: Stock positions in physical commodities

Stock positions in physical commodities associated with a firm's investment business	30% of realisable value

D: Certain derivatives and foreign exchange

Exchange traded futures and written options	4 x initial margin requirement
OTC futures and written options	Apply the percentage shown in C above to the mark to market value of the underlying position
Purchased options	Apply the percentage shown in C above to the mark to market value of the underlying position but the result may be limited to the mark to market value of the option

Contracts for differences	20% of the mark to market value of the contract
Foreign exchange exposure	10% of the net open long position

F: Other investments

Single premium unit linked bonds and units in a regulated collective investment scheme		50% of realisable value
Any other investments		100% of mark to market value of investment or underlying instrument
Notes		
	Percentage	
1	A percentage means, unless otherwise indicated, a percentage of the mark to market value of the aggregate of the long and the short positions in the particular category.	
	Netting	
2	The long or (short position) in a particular instrument is the net of any long or short positions held in that same instrument (i.e. a long position in ICI shares can be offset on a share for share basis against a short position in ICI shares) but positions in similar instruments (e.g. ICI shares against BP shares) cannot be offset in this way.	
	Stock positions in physical commodities	
3	A stock position in physical commodities is the mark to market value of the sum of -	
	(i)	commodities where the full contract price has been paid;
	(ii)	work in progress and finished goods which result from the processing of commodities; and
	(iii)	raw materials which will be combined with commodities to produce a finished processed commodity.
4	A stock position in physical commodities is regarded as being associated with a firm's investment business if the contract associated with the physical commodity was made for investment rather than commercial purposes. Indications of this are -	
	(i)	the contract is exchange traded or
	(ii)	the performance of the contract is guaranteed by an exchange an approved exchange or a clearing house.

Models approach to PRR calculation

3-80(10) G

A firm that wishes to use its internal model to calculate PRR in respect of all, or some, of its positions will need to apply for a modification or waiver of the relevant FCA rules.

3-80(10) G

Further guidance on the criteria which such models must meet, and the review process, can be obtained from the FCA.

FOREIGN CURRENCY EXPOSURES AND FOREIGN CURRENCY DERIVATIVES METHODS

Summary of foreign currency exposures and derivatives methods

3-150 R

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

3-151 TYPES OF EXPOSURES TO BE TREATED AS FOREIGN CURRENCY EXPOSURES

General rule

3-151(1) R

A firm must apply the foreign currency exposures or foreign currency derivatives method to the following positions, identifying each currency separately including the currency of its books of account:

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

Dual currency bonds

3-152(2) R

In respect of a dual currency bond, a firm must include within the foreign currency exposures method a notional forward contract:

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

Determining the currency of investments

3-151(3) R

For the purposes of determining the currency in which a position in an investment is denominated, a firm must apply the following principles:

(a) where the price of an instrument is quoted in only one currency, a position in that instrument must be treated as an asset or liability in that currency;

(b) where the price of an instrument is quoted in more than one currency, a position in that instrument must be treated as an asset or liability in the currency in which the firm accounts for the instrument; and

(c) notwithstanding (a) and (b) above, a position in an American depository receipt or similar form of instrument must be treated as a position, translated at current spot rate, in the currency of the underlying instrument.

3-152 APPLICATION OF FOREIGN CURRENCY EXPOSURES AND DERIVATIVES METHODS TO FOREIGN CURRENCY DERIVATIVES

Risk assessment models

3-152(1) G

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

Obligatory use of foreign currency derivatives method

3-152(2) R

A firm must apply the foreign currency derivatives method to any currency option which is less than 5% "in the money".

Optional use of foreign currency derivatives method

3-152(3) R

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

Obligatory use of foreign currency exposures method

3-152(4) R

A firm must apply the foreign currency exposures method to any OTC currency future.

Calculation of "in the money"

3-152(5) R

For the purposes of this rule, a firm must determine the extent to which the option contract is "in the money" by reference to the difference between the exercise price and the current forward rate for the final date on which the option may be exercised as a percentage of that forward rate.

3-153 FOREIGN CURRENCY DERIVATIVES METHOD

Exchange traded futures and options

3-153(1) R

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

OTC foreign currency options

3-153(2) R

A firm must calculate the PRR of an OTC foreign currency option as 5% of the nominal value of the contract, adjusted as follows:

(a) long position: the PRR may be restricted to the mark to market value of the option; and
(b) short position: the PRR may be reduced (but to no less than zero) by any excess of the exercise value over the mark to market value for a call option or vice versa for a put option.

3-154 FOREIGN CURRENCY EXPOSURE METHOD

Application

3-154(1) R

A firm must apply the foreign currency exposure method to any foreign currency exposure for which the firm has not calculated a PRR under the foreign currency derivatives method.

Calculation of PRR

3-154(2) R

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

Calculation of net open position

3-154(3) R

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

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

COMMODITIES METHOD

Types of positions to be included in the commodities method

3-166 GENERAL RULE

3-166(1) R

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

3-166(1) G

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

3-166(2) R

A firm must calculate the PRR for each commodity separately, except that:

(a) different subcategories of the same commodity that are deliverable against each other may be treated together; and

(b) commodities which are close substitutes for each other, and whose price movements over a minimum period of one year can be shown by the firm to exhibit a stable and reliable correlation of at least 0.9, may be treated together.

3-166(2) G

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

3-166(3) R

(a) Positions which are purely stock financing may be omitted from the calculation of PRR on commodities positions under rule 3-166 and a firm may net notional long and short government securities arising from swaps, FRAs, futures and options on interest rates

and debt securities, cash borrowings, qualifying deposits, the cash legs of "repurchase or similar agreements", forward foreign exchange and foreign currency futures against each other, provided:

(i) they are in the same currency;
(ii) the interest rates are within 15 basis points;

(iii) (aa) if the maturity dates are less than one month, the dates are the same;
(bb) if the maturity dates are between one month and one year, the dates are within seven days of each other; or
(cc) if the maturity dates are over one year, the dates are within 30 days of each other;

(iv) for a cash borrowing, the next interest rate refix date is within two years and repayment is within two years; and
(v) for a qualifying deposit, the next interest rate refix date is within three months.

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

3-166(3) G

[deleted]

3-167 SIMPLIFIED APPROACH

3-167(1) R

All positions in commodities or commodity derivatives must be expressed in terms of the standard unit of measurement for that commodity (such as tonnes, barrels or kilos).

3-167(2) R

A firm must multiply the position in each commodity by the current spot price for the commodity converted to the firm's reporting currency at current spot rates, and calculate the PRR as the sum of:

(a) the overall net position multiplied by 15%; and
(b) the gross position multiplied by 3%.

3-167(3) R

A firm must sum the results for each commodity to arrive at the total PRR for positions treated under the simplified approach.

3-168 MATURITY LADDER APPROACH

3-168(1) R

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

Table 3-168

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

3-168(2) R

A firm may then offset long and short positions within and between maturity bands in accordance with the following:

(a) For markets which have daily delivery dates, a firm may offset contracts in the same commodity against each other provided that the expiry dates are within 10 business days of each other.

(b) For each maturity band, the firm must sum all the open long positions, and sum all the open short positions. The firm may then subtract the shorts from the longs to form the overall net position. The amount subtracted is the "matched amount". The firm must multiply twice the matched amount by the spread rate of 1.5%, and then by the spot price for the commodity to arrive at the spread risk charge.

3-168(2) G

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

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

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

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

(d) The firm must multiply any positions remaining after the permitted offsetting by the outright rate of 15%, and then by the spot price of the commodity to arrive at the outright charge.

(e) The total PRR for each commodity is the sum of the spread risk charge, the carry charge, and the outright charge converted to the firm's reporting currency at current spot rates.

Extended maturity ladder approach

3-169 R

A firm may adopt the same approach as that outlined under rule 3- 168(2), but apply the rates in the table below, if the firm:

(a) undertakes significant commodities business, and

(b) has a diversified commodities portfolio.

Table 3-169

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

Models approach

3-169A G

A firm may seek a modification or waiver from the FCA to use a VaR model as the basis for calculating the PRR on its commodity positions.

3-169 A G

The FCA will grant a modification or waiver permitting the use of a VaR model only where a number of qualitative and quantitative standards are met. In assessing the VaR model the FCA will have regard to the the matters set out in BIPRU 7.10 as it applied on 31 December 2021.

3-169 B OPTIONS

Proprietary options pricing models

3-169B(1) G

A firm may seek a modification or waiver from the FCA permitting it to use its proprietary options pricing model to calculate the PRR on options positions and their related hedges. The application for a modification or waiver may request that the firm be permitted to include an option in the maturity ladder approach.

3-169B(1) G

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

No models

3-169B(2) R

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

3-169B(3) R

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

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

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

3-169B(3) G

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

COUNTERPARTY RISK REQUIREMENT

3-170 GENERAL PRINCIPLES OF CRR

Application

3-170(1) R

(a) Rules 3-170 to 3-182 apply to a broad scope firm, except a venture capital firm which is subject only to rules 3-180 to 3- 182.

(b) Rules 3-180 to 3-182 apply to an arranger, except a corporate finance advisory firm.

General rule

3-170(2) R

A firm must calculate its total CRR on exposures to counterparties as the sum of all the amounts calculated in accordance with the rules referred to in the table below.

Table 3-170(2) - Counterparty Risk Requirement

Rules

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

Frequency of calculation

3-170(3) R

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

Negative amounts

3-170(4) R

A firm must not include any CRR if it is a negative amount.

Instruments for which no CRR has been specified

3-170(5) R

Where a firm is in doubt as to the classification of an item for the purposes of CRR, the firm must add to its CRR an appropriate part of the exposure on the item concerned and must immediately notify the FCA in writing of details of the transaction, the counterparty and the proposed CRR treatment.

3-170(5A) E

(1) In 3-170(5) "an appropriate part" is:

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

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

Provisions

3-170(6) R

A firm may reduce the exposure on which its CRR is calculated to the extent that it makes provision for a specific counterparty balance.

Connected companies

3-170(7) R

For the avoidance of doubt, a firm must calculate a CRR as appropriate on exposures to or from connected companies.

Basis of valuation

3-170(8) R

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

Acceptable collateral

3-170(9) R

A firm may reduce the exposure to a counterparty on which its CRR is calculated to the extent that it holds acceptable collateral from that counterparty.

Nil weighted counterparty exposures

3-170(10) R

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

Netting

3-170(11) R

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

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

3-170(11) G

Legal opinions should relate to:

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

Where a firm uses an industry standard agreement and the firm's netting/setoff clauses follow the form of that standard agreement, provided a legal opinion has already been obtained on the standard agreement which addresses the capacity of counterparties of the type with which the firm wishes to contract, that may be relied upon.

Legal opinions on netting agreements should be obtained from independent legal advisers with sufficient expertise and experience in this area of law. Opinions from in-house counsel will not be acceptable. Where the regulator of the counterparty is not satisfied that the netting agreement is enforceable under its laws, the netting agreement cannot be relied upon regardless of the opinions obtained by the firm.

3-171 CASH AGAINST DOCUMENTS TRANSACTIONS

General rule

3-171(1) R

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

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

Calendar days after settlement day	Percentage

0-15	Nil
16-30	25%
31-45	50%
46-50	75%
Over 60	100%

Counterparty exposure calculation

3-171(2) R

(a) Where a firm has neither delivered securities or physical commodities nor received payment when purchasing securities or physical commodities for, or selling securities or physical commodities to, a counterparty, the positive counterparty exposure is the excess of the contract value over the market value of the securities or physical commodities.

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

Netting

3-171(2A) R

A firm may offset positive and negative counterparty exposures, calculated in accordance with (2) above, before it multiplies the residual exposure by the appropriate percentage in Table 3-171(1) provided that:

(a) the exposures arise on transactions with the same counterparty; and

(b) the firm has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11).

Sub-total

3-171(3) R

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

3-173 FREE DELIVERIES OF PHYSICAL COMMODITIES AND SECURITIES

General rule

3-173(1) R

When a firm makes delivery to a counterparty of physical commodities or securities without receiving payment or pays for securities without receiving the certificates of good title, the firm must calculate the free delivery value for each transaction.

Free delivery value calculation

3-173(2) R

A firm must calculate the free delivery value for each transaction as set out below and multiply this value by the appropriate percentage in Table 3-173(2) A for free deliveries of physical commodities and Table 3-173(2) B for free deliveries of securities as follows:

(a) if the firm has delivered physical commodities or securities to a counterparty and has not received payment, the free delivery amount is the full amount due to the firm (i.e. the contract value);

(b) if the firm has made payment to a counterparty for securities and not received the certificates of good title, the free delivery amount is the market value of the securities; and

(c) if a firm pays for physical commodities without receiving delivery or documents of title the exposure is to be treated as an unsecured loan to which rule 3-181 applies.

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

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

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

	Nature of counterparty to whom free delivery is made	**Business days since delivery**		
		0-3	4-15	Over 15
1	A counterparty to whom securities have been delivered or to whom payment for securities has been made	Nil	100% of contract or market value	100% of contract or market value
2	A regulated financial institution or regulated banking institution to whom securities have been delivered or payment made with the expectation that market practice will result in a settlement day longer than three days from delivery date	15% of contract or market value		100% of contract or market value
2A	A counterparty to whom securi-	15% of contract or market		100% of contract or

	ties have been delivered which settle through the Crest system or to whom payment for such securities has been made	value	market value
3	A manager, underwriter, subunderwriter or member of a selling syndicate or issuer to whom payment for securities has been made; or a manager of a regulated collective investment scheme to whom units of the scheme have been delivered or payment for units of the scheme has been made	nil	100% of contract or market value or, if the issue is in one of the countries specified in Appendix 46, 15% of contract or market value until the end of the period referred to in that Appendix

Netting

3-173 (2A) R

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

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

provided that:

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

Partners and connected persons

3-173 (3) R

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

Sub-total

3-173 (4) R

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

3-173A DERIVATIVE TRANSACTIONS

General rule

3-173A (1) R

A firm must calculate for each derivative transaction a CRR either:

(a) by multiplying the counterparty exposure calculated in accordance with (2) and (3) below by the appropriate percentage in Table 3-173A(4)A or B, except for single premium options purchased on behalf of a counterparty and traditional options purchased for the firm's own account or on behalf of a counterparty, which shall be subject to rule 3-178; or

(b) after notifying the FCA in writing, in accordance with rule 3- 173B.

Counterparty exposure

3-173A (2) R

A firm must calculate the counterparty exposure on derivative transactions in accordance with either (a) or (b) below:

(a) where a counterparty has not fully paid an initial margin requirement or variation margin requirement on a transaction in a derivative listed on an exchange or approved exchange or met it through the deposit of acceptable collateral not otherwise used, the firm must calculate the counterparty exposure as the shortfall;

(b) where the counterparty exposure arising from a transaction in a derivative is not listed on an exchange or approved exchange, the counterparty exposure is the credit equivalent amount calculated in accordance with Table 3-173A(2A).

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

Type of derivative transaction	**Credit equivalent amount**	
	If A is positive	**If A is negative**
Interest rate swaps: single currency		
(a) floating rate swapped against floating rate	A	nil
(b) fixed rate swapped against floating rate:		
- under one year to maturity	A	nil
- over one year to five years	A + 0.5% of N	0.5% of N
- over five years	A + 1.5% of N	1.5% of N
Cross-currency interest rate swaps		
- under one year to maturity	A + 1% of N	1% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Other interest rate contracts*		
- under one year to maturity	A	nil
- over one year to five years	A + 0.5% of N	0.5% of N
- over five years	A + 1.5% of N	1.5% of N
Foreign exchange and gold contracts*		
- exchange rate contracts with an original maturity of 14 days or less	nil	nil
- under one year to maturity	A + 1% of N	1% if N
- over one year to five years	A + 7.5% of N	5% of N
- over five years	A + 5% of N	7.5% of N
Equity contracts*		
- under one year to maturity	A| + 6% of N	6% of N
- over one year to five years	A + 8% of N	8% of N
- over five years	A + 10% of N	10% of N

Precious metal (not gold) contracts*		
- under one year to maturity	A + 7% of N	7% of N
- over one year to five years	A + 7% of N	7% of N
- over five years	A + 8% of N	8% of N
Commodity contracts*		
- under one year to maturity	A + 10% of N	10% of N
- over one year to five years	A + 12% of N	12% of N
- over five years	A + 15% of N	15% of N
Notes FRAs, swaps, futures, purchased options, and other contracts for differences A = the replacement cost of the contract N = the notional or actual principal amount underlying the contract For contracts with multiple exchanges of principal, the % of N has to be multiplied by the remaining number of payments still to be made according to the contract. In the case of a derivative referenced on a bond which satisfies the criteria for a qualifying debt security, the %N applicable to interest rate derivatives may be utilised to calculate the credit equivalent amount. For a derivative referenced on a 'non-qualifying' bond, the credit equivalent amount must be calculated with reference to the %N applicable to equity derivatives. For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage is no lower than 0.5%.		

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

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

Type of derivative transaction*	**Credit equivalent amount** **If A is positive**	**If A is negative**
Precious metals (except gold)		
- under one year to maturity	A + 2% of N	2% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Base metals		
- under one year to maturity	A + 2.5% of N	2.5% of N
- over one year to five years	A + 4% of N	4% of N
- over five years	A + 8% of N	8% of N
Softs (agricultural)		
- under one year to maturity	A + 3% of N	3% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 9% of N	9% of N
Other commodity		
- under one year to maturity	A + 4% of N	4% of N
- over one year to five years	A + 6% of N	6% of N
- over five years	A + 10% of N	10% of N
Notes FRAs, swaps, futures, purchased options, and other contracts for differences A = the replacement cost of the contract N = the notional or actual principal amount underlying the contract For contracts with multiple exchanges of principal, the % of N has to be multiplied by the remaining number of payments still to be made according to the contract. In the case of a derivative referenced on a bond which satisfies the criteria for a qualifying debt security, the		

%N applicable to interest rate derivatives may be utilised to calculate the credit equivalent amount.
For a derivative referenced on a 'non-qualifying' bond, the credit equivalent amount must be calculated with reference to the %N applicable to equity derivatives.
For contracts that are structured to settle outstanding exposure following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, the residual maturity would be equal to the time until the next reset date. In the case of interest-rate contracts that meet these criteria and have a remaining maturity of over one year, the percentage is no lower than 0.5%.

Netting

3-173A R

A firm may offset counterparty exposures arising on derivative transactions calculated in accordance with (2) above before it

(3) multiplies the residual exposure by the appropriate CRR percentage as follows:

(a) variation margin payable to a counterparty against an initial margin requirement or variation margin requirement receivable from a counterparty;
(b) variation margin payable to a counterparty against a positive "A" as calculated in accordance with Table 3- 173A(2A);
(c) a negative "A" as calculated in accordance with Table 3- 173A(2A) against an initial margin requirement or variation margin requirement receivable from a counterparty;
(d) a negative "A" against a positive "A" in each case as calculated in accordance with Table 3-173A(2A);
(e) losses on a closed out derivative transaction which has not been settled against variation margin payable to a counterparty; or
(f) losses on a closed out derivative transaction which has not been settled against negative "A" calculated in accordance with Table 3173A(2A),
(g) profit on a closed out derivative transaction which has not been settled against an initial margin requirement or variation margin requirement receivable from a counterparty;
(h) profit on a closed out derivative transaction which has not been settled against a loss on a closed out derivative transaction;
(i) profit on a closed out derivative transaction which has not been settled against a positive "A" as calculated in accordance with Table 3-173A(2A);
(j) premium receivable in respect of written options against variation margin payable, initial margin payable or a closed out profit payable to the counterparty or a negative "A" as calculated in accordance with Table 3-173A(2A);
(k) positive "A" on purchased options calculated in accordance with Table 3-173A(2A) against negative "A" on written options; or
(l) in the case of perfectly matched contracts these may be treated as a single contract with a notional principal equivalent to the net receipts; or
(m) where transactions are subject to (3)(c) above, the potential future credit exposures (PFCE) on transactions with the same counterparty (i.e. % on N) may be netted in accordance with Table 3-173A(3) below,

provided that:

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

Table 3-173A(3)

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

CRR percentages

3-173A (4) R

(a) Where a firm does not offset counterparty exposures arising on derivative transactions in accordance with (3) above, it must multiply the counterparty exposure by the appropriate percentage from:

(i) Table 3-173A(4)A if the counterparty exposure arises on a transaction in a derivative listed on an exchange or approved exchange; or

(ii) Table 3-173A(4)B if the counterparty exposure arises on a transaction in a derivative not listed on an exchange or approved exchange,

but may opt to calculate CRR using the highest available credit percentage in Tables 3-173A(4)A or B below in order to avoid undue complication.

(b) Where a firm does offset counterparty exposures on derivative exposures in accordance with (3) above, it must multiply the residual net counterparty exposure by the appropriate percentage from Table 3-173A(4)A or B.

(c) A firm may opt to calculate the CRR using the highest available CRR percentage in the tables below in order to avoid undue complication.

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

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

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

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

2	Any other counterparty	5%

Exposures to local firms

3-173A (5) R

A firm must calculate a 100% CRR for amounts of initial and variation margin not met with acceptable collateral or a positive equity balance owed to a firm by a local firm in respect of transactions in derivatives listed on an exchange or approved exchange from the date of any shortfall. However, a firm may use an alternative treatment if it:

(a) participates in the profits or losses of the local firm for 25% or more when the firm may include the local firm position in its own position which will then be subject to PRR; or

(b) calculates PRR for local firms in which case its requirement will be the sum of the following:

(i) 10% of the PRR result for each local firm; and

(ii) the excess over the "net liquidating balance" of the PRR applied to the positions of each local firm; and

(c) for the purposes of (b) above, "net liquidating balance" means the cash amount which would remain in a local firm account if all positions were liquidated and there were added (1) cash balances (2) the value of marketable investments, and (3) letters of credit and guarantees issued by a regulated banking institution which is not the counterparty or an associate of the counterparty in the control of the firm; and there were deducted all loans and overdrafts from, and other liabilities to the firm; and to the extent that a firm includes an exposure in the net liquidating balance calculation, it does not also need to apply the liquidity adjustment in rule 3-75 or the CRR to those exposures.

Sums due for payment or owed on closed out derivative transactions

3-173A (6) R

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

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

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

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

Equivalent contracts

3-173A (7) R

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

Regulated connected companies

3-173A (8) R

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

Sub-total

3-173A (9) R

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

3-173B CRR for derivative transactions under 3-173A(1)(b)

General rule

3-173B (1) R

A firm must calculate for each derivative transaction a CRR by multiplying the counterparty exposure calculated in accordance with (2) and (3) below, by the appropriate percentage in Table 3- 173B(5) below.

Collateral

3-173B (2) R

A firm may:

(a) reduce the counterparty exposure on which its CRR is calculated to the extent that it holds acceptable collateral to cover that exposure; and

(b) where it does not have an ACMP, may continue to multiply the counterparty exposure by 8% multiplied by the counterparty weight, to the extent that the firm holds adequate collateral to cover that exposure.

Counterparty exposure

3-173B (3) R

A firm must calculate the counterparty exposure on derivative transactions in accordance with either (a), (b) or (c) below:

(a) where a counterparty has not fully paid a margin requirement on a derivative transaction listed on an exchange or cleared through a clearing house, or met it through the deposit of acceptable collateral not otherwise used, a firm must calculate the counterparty exposure as the shortfall;

(b) where a firm sells or writes an option to a counterparty or buys an option on behalf of a counterparty and the counterparty has not paid the full option premium, or met it through the deposit of acceptable collateral not otherwise used, it must calculate the counterparty exposure as the uncovered premium on the transaction; or

(c) a firm must calculate the counterparty exposure arising from a derivative transaction other than a written or sold option or a derivative transaction listed on an exchange or cleared through a clearing house, as the credit equivalent amount calculated in accordance with Table 3-173B(3A), not covered by the deposit of acceptable collateral not otherwise used.

Table 3-173B(3A) - Method of calculating credit equivalent amount

Type of derivative transaction	**Credit equivalent amount**	
	If A is positive	**If A is negative**
Interest rate swaps: single currency (a) floating rate swapped against floating rate A nil	A	nil
(b) fixed rate swapped against floating rate: - under one year to maturity - over one year to five years - over five years	 A A + 0.5% of N A + 1.5% of N	 nil 0.5% of N 1.5% of N
Cross-currency interest rate swaps - under one year to maturity - over one year to five years - over five years	 A + 1% of N A + 5% of N A + 7.5% of N	 1% of N 5% of N 7.5% of N
Other interest rate contracts* - under one year to maturity - over one year to five years - over five years	 A A + 0.5% of N A + 1.5% of N	 nil 0.5% of N 1.5% of N
Foreign exchange and gold contracts* - exchange rate contracts with an original maturity of 14 days or less - under one year to maturity - over one year to five years - over five years	nil A + 1% of N A + 5% of N A + 7.5% of N	nil 1% of N 5% of N 7.5% of N
Equity contracts* - under one year to maturity - over one year to five years - over five years	 A + 6% of N A + 8% of N A + 10% of N	 6% of N 8% of N 10% of N
Precious metal (not gold) contracts* - under one year to maturity - over one year to five years - over five years Commodity contracts* - under one year to maturity - over one year to five years - over five years	 A + 7% of N A + 7% of N A + 8% of N A + 10% of N A + 12% of N A + 15% of N	 7% of N 7% of N 8% of N 10% of N 12% of N 15% of N
Notes * FRAs, swaps, futures, purchased options, and other contracts for differences A = the replacement cost of the contract N = the notional or actual principal amount or value underlying the contract For contracts with multiple exchanges of principal, the % of N has to be multiplied by the remaining number of payments still to be made according to the contract. In the case of a derivative referenced on a bond which satisfies the criteria for a qualifying debt security, the %N applicable to interest rate derivatives may be utilised to calculate the credit equivalent amount. For a derivative referenced on a 'non-qualifying' bond, the credit equivalent amount must be calculated with reference to the %N applicable to equity derivatives.		

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

If a firm uses the modified maturity ladder approach to calculate PRR, it may use Table 3-173B(3B).

Table 3-173B(3B) - Method of calculating credit equivalent amount for commodities

Type of derivative transaction*	**Credit equivalent amount**	
	If A is positive	**If A is negative**
Precious metals (except gold)		
- under one year to maturity	A + 2% of N	2% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 7.5% of N	7.5% of N
Base metals		
- under one year to maturity	A + 2.5% of N	2.5% of N
- over one year to five years	A + 4% of N	4% of N
- over five years	A + 8% of N	8% of N
Softs (agricultural)		
- under one year to maturity	A + 3% of N	3% of N
- over one year to five years	A + 5% of N	5% of N
- over five years	A + 9% of N	9% of N
Other commodity		
- under one year to maturity	A + 4% of N	4% of N
- over one year to five years	A + 6% of N	6% of N
- over five years	A + 10% of N	10% of N

Notes

FRAs, swaps, futures, purchased options, and other contracts for differences

A = the replacement cost of the contract

N = the notional or actual principal amount or value underlying the contract

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

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

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

Sums due for payment or owed on closed out derivative transactions

3-173B (4) R

When a counterparty has not fully met amounts owed to a firm arising out of losses on closed out derivative transactions through the deposit of acceptable collateral not otherwise used, or has not fully settled amounts

owed in respect of periodic or final settlement of transactions, a firm must calculate CRR equal to the unpaid loss multiplied by the appropriate percentage from the Table 3-173B(5) below.

3-173B (4A) R

In the case of a failed FX transaction (whether originally contracted for forward settlement, or undertaken in the spot market) where the firm has released funds to its counterparty, but has not received the funds in the alternative currency, the CRR must be calculated as the gross value of the funds not received, multiplied by the appropriate percentage from Table 3- 173B(5) below.

CRR percentages

3-173B (5) R

A firm must multiply the counterparty exposure by the appropriate percentage from the table below, but:

(a) may opt to calculate CRR using the highest available credit percentage in the table below in order to avoid undue complication; and

(b) may reduce the counterparty weight applicable to counterparty exposures calculated in accordance with (3)(c) above to 50%, where the counterparty would normally attract a counterparty weight of 100% in accordance with Table 1 in Appendix 47.

TABLE 3-173B(5) - CRR percentages

Type of contract	**Nature of** counterparty **to whom** counterparty	**Business days after** counterparty **exposure first**	
		0 - 5	6 or more
Failed FX transaction	Any	8% x counterparty weight*	100%
Other	A counterparty granted a credit line under an ACMP	8% x counterparty weight*	
	A counterparty not granted a credit line under an ACMP	8% x counter party weight*	100%

Netting

3-173B (6) R

A firm may offset counterparty exposures arising on derivative transactions calculated in accordance with (2), (3) and (4) above before it multiplies the residual exposure by the appropriate CRR percentage as follows:

(a) variation margin payable to a counterparty against an initial margin requirement or variation margin requirement receivable from a counterparty;

(b) variation margin payable to a counterparty against a positive "A" as calculated in accordance with Table 3-173B (3A);

(c) a negative "A" as calculated in accordance with Table 3- 173B(3A) against an initial margin requirement or variation margin requirement receivable from a counterparty;

(d) a negative "A" against a positive "A" in each case as calculated in accordance with Table 3-173B(3A);

(e) loss on a closed out derivative transaction which has not been settled against variation margin payable to a counterparty;

(f) loss on a closed out derivative transaction which has not been settled against negative "A" calculated in accordance with Table 3-173B(3A);
(g) profit on a closed out derivative transaction which has not been settled against an initial margin requirement or variation margin requirement receivable from a counterparty;
(h) profit on a closed out derivative transaction which has not been settled against a loss on a closed out derivative transaction;
(i) profit on a closed out derivative transaction which has not been settled against a positive "A" as calculated in accordance with Table 3-173B(3A);
(j) premium receivable in respect of written options against variation margin payable, initial margin payable or a closed out profit payable to the counterparty or a negative "A" as calculated in accordance with Table 3-173B(3A);
(k) where the firm has received the premium due for a written option, a negative "A" (the replacement cost) for the written option against a positive "A" in each case as calculated in accordance with Table 3-173B(3A); or
(l) in the case of perfectly matched contracts these may be treated as a single contract with a notional principal equivalent to the net receipts; or
(m) where transactions are subject to (3)(c) above, the potential future credit exposures (PFCE) on transactions with the same counterparty (i.e. % o N) may be netted in accordance with Table 3-173B(6) below,

provided that:

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

Table 3-173B(6)

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

Equivalent contracts

3-173B (7) R

Rule 3-173B(3)(c) also applies to contracts, which, although they are listed on an exchange are fully dependent upon the issuer for performance (e.g. covered warrants).

Sub-total

3-173B (8) R

The sum of the amounts calculated in accordance with this rule is the firm's CRR for derivative transactions.

3-175 CONCENTRATED RISK TO ONE COUNTERPARTY

General rule

3-175(1) R

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

Table 3-175(1) - Concentrated risk percentages

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

Use of approved bank bonds

3-175(2) R

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

Sub-total

3-175(3) R

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

3-176 R

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

Repurchase, securities lending and sale and buy back agreements

3-176(1) R

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

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

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

Reverse repurchase, securities borrowing and buy and sale back agreements

3-176(2) R

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

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

Type of security purchased or borrowed			**CRR**
1	For all transactions where the firm has in its possession a "written agreement" evidencing the transaction, in accordance with rule 3-176(5)		
	a)	qualifying debt securities	The amount paid or collateral given for the securities less 105% of the current "mark to market value" of the securities received (see note), if the net figure is positive
	b)	other securities or physical	The amount paid or collateral given for the securities or physical commodities less 110% of the current "mark to market value" of the securities or physical commodities commodities received (see note), if the net figure is positive
2	Where a firm does not have in its possession a "written agreement" evidencing the transaction, in accordance with rule 3-176(5)		The appropriate requirements from 1 plus the market value of the securities or physical commodities multiplied by the appropriate percentage risk addition.
Note: the securities or physical commodities received can be included only where they are held under the control of the firm or where they were delivered into the control of the firm upon initiation of the agreement.			

Netting

3-176(3) R

A firm may reduce the CRR by netting where it has more than one exposure to an individual counterparty provided that it has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11) as follows:

(a) in the case of sale and buy back, repurchase or securities or physical commodities lending agreements (Table 3- 176(1)), a firm may reduce the CRR by the excess of the total value of collateral received, including accrued interest, over the "mark to market" value of any other sale and buy back, repurchase or securities or physical commodities lending agreements with the same counterparty;

(b) in the case of sale and buy back, reverse repurchase or securities or physical commodities borrowing agreements (Table 3-176(2)), a firm may reduce the CRR by the excess of the "mark to market value" over the total value of collateral given, including accrued interest, of any other of buy and sale back, reverse repurchase or securities or physical commodities borrowing agreements with the same counterparty; and

(c) to the extent that an excess has not been used under (a) or (b) above to reduce the CRR, a firm may use an excess on a sale and buy back, repurchase or securities or physical commodities lending agreement respectively to reduce the CRR on a buy and sale back, reverse repurchase or securities or physical commodities borrowing agreement and vice versa provided the agreements are with the same counterparty.

Margin percentages

3-176(4) R

A firm may opt to calculate the CRR using the lower collateral rate (105%) in order to avoid undue complication.

"Written agreement"

3-176(5) R

For the purpose of this rule and rule 3-177(2), a "written agreement" must, whether in a general agreement or in respect of specific occasions, include the following elements:

(a) the names of the persons involved;

(b) the type and quantity of securities or physical commodities subject to the reverse repurchase, securities or physical commodities borrowing, or buy and sale back agreement;

(c) the type and quantity of collateral;

(d) the commencement date of the reverse repurchase, securities or physical commodities borrowing or buy and sale back agreement;

(e) the completion date of the reverse repurchase, securities or physical commodities borrowing or buy and sale back agreement, where appropriate;

(f) interest or fee arrangements, where appropriate;

(g) arrangements for adjustments in the amount or type of securities or physical commodities to be returned, if appropriate;

(h) arrangements for the calling of margin, if appropriate; and

(i) agreements for completion,

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

"Mark to market value"

3-176(6) R

For the purposes of this rule, the current "mark to market value" of securities and the value of cash lodged must include accrued interest.

Daily valuation

3-176(7) R

A firm must value collateral and securities or physical commodities lent or sold, or borrowed or purchased, at least daily.

Settlement failure and pre deliveries

3-176(8) R

Where:

(a) simultaneous delivery of securities or physical commodities and collateral cannot be confirmed immediately due to settlement failure, or
(b) a firm has delivered collateral or securities or physical commodities prior to the receipt of securities or physical commodities or collateral,

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

Additional acceptable collateral

3-176(9) R

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

Exclusions

3-176(10) R

All repurchase, reverse repurchase, securities or physical commodities lending or borrowing sale and buy back and buy and sale back agreements with a stock exchange, clearing house, Clearstream or Euroclear are exempt from this rule.

Sub-total

3-176(11) R

The sum of the amounts calculated in accordance with this rule is the total CRR for repurchase and reverse repurchase, securities or physical commodities lending and borrowing and sale and buy back agreements.

3-177 MONEY BROKERS

Application

3-177(1) R

This rule applies to money brokers.

Lending money

3-177(2) R

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

Lending and borrowing securities etc

3-177(3) R

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

Sub-total

3-177(5) R

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

3-178 OPTIONS PURCHASED FOR A COUNTERPARTY

Single premium options

3-178(1) R

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

Traditional options

3-178(2) R

Where a firm has purchased a traditional option for its own account or a counterparty and paid the option premium, it must calculate a CRR equal to the value of the option premium.

Sub-total

3-178(3) R

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

3-180 QUALIFYING AND OTHER DEPOSITS

General rule

3-180(1) R

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

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

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

Timing

3-180(2) R

Qualifying deposits and other deposits outstanding three days after a repayment request has been made or more than three days past maturity date are subject to a full CRR.

Netting

3-180(2A) R

A firm may reduce the value of the deposit by an amount owed by the firm to a counterparty before it multiplies the residual exposure by the appropriate percentage in Table 3-180(1) provided that:

(a) the exposures arise with the same counterparty; and
(b) the firm has a written agreement supported by a legal opinion obtained in accordance with rules 3-170(11).

Sub-total

3-180(3) R

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

3-181 LOANS TO COUNTERPARTIES

General rule

3-181(1) R

A firm must calculate a 100% CRR on the amount by which a loan to a counterparty is not:

(a) secured by acceptable collateral; or
(b) offset against amounts owed by the firm to the counterparty where the firm has a written agreement supported by a legal opinion obtained in accordance with rule 3-170(11).

Sub-total

3-181(2) R

The sum of the amounts calculated in accordance with this rule is the firm's CRR for loans to counterparties.

3-182 OTHER AMOUNTS OWED TO A FIRM ARISING OUT OF INVESTMENT BUSINESS OR INVESTMENT DEALING ACTIVITIES

Nil CRR items

3-182(1) R

The following receivables arising out of investment business or investment dealing activities do not require a CRR at any time:

(a) any debt not covered elsewhere in the CRR rules to the extent that it is adequately secured;
(b) amounts in respect of 30 day items specified in (3) below which have been outstanding for less than 30 days from the date on which they were first recorded on the firm's balance sheet; and

(c) accrued income for interest on marketable investments, except where it has been outstanding for more than 30 days after the date that the interest was due to be received.

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

3-182(2) R

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

CRR on 30 day items

3-182(3) R

A firm must calculate a 100% CRR in respect of the following receivables due to the firm if they have been outstanding for more than 30 days from the date on which they were first recorded on the firm's balance sheet:

(a) commissions and fees earned in connection with the firm's investment business;
(b) commissions and fees earned which are due and payable from client bank accounts;
(c) repayments of marketable investments at maturity or call;
(d) the value of scrip issues and rights issues;
(e) proceeds arising from takeovers and mergers;
(f) domestic underwriting or stabilisation fees; and
(g) accrued income and work in progress.

100% CRR items

3-182(4) R

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

Netting

3- 182(4A) R

A firm may reduce the value of the amounts owed to the firm by an amount owed by the firm to a counterparty before it multiplies this by 100% provided that:

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

Sub-total

3-182(5) R

The sum of the amounts calculated in accordance with this rule is the CRR for other amounts owed to the firm arising out of investment business or investment dealing activities

Consolidated Supervision

[deleted]

3-300 ACMPS

3-300(1) R

A firm may only use an ACMP for the purposes of rules 3-170 to 3-182 if:

(a) the policies and procedures making up the proposed ACMP are at all times adequate and appropriate to the firm and its business; and
(b) the firm gives to the FCA at least three months' notice in writing of its intention to use an ACMP for the purposes of these rules.

3-300(2) R

The notice referred to in (1)(b) above must include all relevant details of the policies and procedures making up the proposed ACMP.

3-300(3) R

The notice referred to in (1)(b) is not required if the firm was permitted under the relevant requirements of a predecessor regulator, as they were in force immediately prior to the specified day, to use the proposed ACMP for the purposes of those requirements.

3-300(4) E

(a) A firm's policies and procedures should take full account of the principles described in Appendix 56.
(b) Compliance with 3-300(4)(a) may be relied on as tending to establish compliance with 3-300(1)(a).
(c) Contravention of 3-300(4)(a) may be relied on as tending to establish contravention of 3-300(1)(a).

3-300(4) G

On receipt of notice under (1)(b) the FCA is likely to review the policies and procedures proposed by the firm and the degree to which they take full and appropriate account of the matters described in Appendix 56. The FCA's review will take account of the context in which the policies and procedures are to operate and the relevant circumstances of the firm. The FCA will indicate to the firm its views on the adequacy and appropriateness of the proposals in the light of its review and may make recommendations of improvements.

The FCA may make a further review of the policies and procedures making up an ACMP at any time after their implementation for the purposes of these rules as part of its supervision of the firm. Any review after implementation will broadly follow the lines described above.

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

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

acceptable collateral

(1) (other than for the purposes of rule 3-173B) means any of the following items of collateral provided to a firm by a counterparty -

(a) cash;

(b) letters of credit and guarantees to the extent of their face value, issued by a regulated banking institution which is not the counterparty nor an associate of the counterparty;

(c) letters of credit and guarantees to the extent of their face value, issued by a bank which is not a regulated banking institution (not being the counterparty, an associate of the counterparty nor an affiliated company) which has been accepted under the firm's ACMP;

(d) gold and silver bullion and coinage; and

(e) marketable investments,

to which the following conditions apply -

(i) the firm must have an unconditional right to apply or realise the acceptable collateral for the purpose of repaying the counterparty's obligations;

(ii) marketable investments must -

(aa) be marked to market daily using the valuation principles in rule 3-41(9);

(bb) not be issued by the counterparty nor by an associate of the counterparty; and

(cc) be discounted by 8% (before allowances for hedging or diversification); and

(iii) each item of acceptable collateral must be discounted by 5% if it is denominated in a different currency to the counterparty's obligation;

(2) (for the purposes of rule 3-173B) means any of the following items of collateral provided to a firm by a counterparty:

(a) cash;

(b) gold and silver bullion and coinage;

(c) certificates of deposit issued by and lodged with the firm;

(d) securities issued by Zone A central governments and Zone A central banks; and

(e) securities issued by the EU or Euratom (the European Atomic Energy Community),

to which the following conditions apply:

(i) the firm must have an unconditional right to apply or realise the acceptable collateral for the purpose of repaying the counterparty's obligations to the firm; and

(ii) securities must be marked to market daily using the valuation principles in rule 3-41(9);

ACMP

means, subject to rule 3-300, a credit management policy and procedures ac-

cording with the principles discussed in **Appendix 56**;

adequate collateral — means any of the following items of collateral provided to a firm by a counterparty:

(a) cash;

(b) standby letters of credit and unconditional, irrevocable first on demand guarantees to the extent of their face value, issued by a Zone A credit institution which is not the counterparty nor an associate of the counterparty, and which is not an affiliated company, associate or a controller of the firm;

(c) standby letters of credit and unconditional, irrevocable first on demand guarantees to the extent of their face value, issued by a bank which is not a Zone A credit institution (not being the counterparty nor an associate of the counterparty) which has been accepted under the firm's ACMP and which is not an affiliated company, associate or a controller of the firm;

(d) certificates of deposit;

(e) gold and silver bullion and coinage;

(f) securities;

(g) physical commodities; and

(h) the performance guarantees issued in support of the securities lending and borrowing programmes of Euroclear and Clearstream, in respect only of exposure arising from participation in such programmes,

to which the following conditions apply -

(i) the firm must have an unconditional right to apply or realise the collateral for the purpose of repaying the counterparty's obligations to the firm; and

(ii) securities must -

(aa) be marked to market daily using the valuation principles in rule 3- 41(9); and

(bb) not be issued by the counterparty nor by an associate of the counterparty;

adequately secured — means secured by cash or by marketable investments -

(a) in respect of which the firm has an unconditional right to apply or realise for the purpose of repaying the counterparty's obligations to the firm;

(b) which, in the case of marketable investments, are marked to market daily by the firm using the valuation principles in rule 3-41(9);

(c) with, in the case of marketable investments, a marked to market value not lower than the current value of that obligation after being discounted -

(i) by 8% (before allowances for hedging or diversification); and

(ii) at an additional 5% if it is denominated in a different currency to the obligation; and

(d) which, in the case of marketable investments, must not be issued by the counterparty nor by an associate of the counterparty;

adviser — means a firm which -

(a) has counterparties who are investors or potential investors;

(b) restricts its investment business to activities within article 53 (advising on investments) of the Regulated Activities Order;

(c) does not hold, receive or control money or property belonging to another person, nor has a mandate over a customer's bank account;

(d) does not introduce its counterparties to other persons as its main business; and

(e) does not deal as principal or agent in investments or physical commodities;

affilitated company — in relation to a firm, means any body corporate controlled by the firm, any parent company of the firm, and any body corporate controlled by a parent company of the firm;

agency broker — means a broad scope firm which deals as principal only on an incidental basis;

agent — in relation to a person, means any person (including an employee) who acts on that person's behalf;

allotment date — means the date on which allotments are first made in respect of the securities being

offered;

annual accounting reference date	means the date as at which the annual financial statements are prepared as initially notified by the firm to the FCA or as subsequently notified under rule 3- 31 for all other purposes and which may not be more than 55 weeks since the previous annual accounting reference date or, if applicable, the date on which the firm commenced trading;
annual financial statements	means statements drawn up in accordance with whichever of the following is applicable at the firm's annual accounting reference date: (i) Schedule 4 to the Companies Act 1985; (ii) Schedule 1 to the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (SI 2008/409); (iii) Schedule 1 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410); or (iv) Schedule 1 to the Small Limited Liability Partnerships (Accounts) Regulations 2008 (SI 2008/1912); or (v) Schedule 1 to the Large and Medium-sized Limited Liability Partnerships (Accounts) Regulations 2008 (SI2008/1913); or (vi) international accounting standards.
appointed representative	(in accordance with section 39 of the Act) means a person (other than an authorised person) who: (a) is a party to a contract with an authorised person (his principal) which: (i) permits or requires him to carry on business of a description prescribed in the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001 (SI 2001/1217); and (ii) complies with the requirements prescribed in those Regulations; and (b) is someone for whose activities in carrying on the whole or part of that business his principal has accepted responsibility in writing;
approved bank	(in relation to a bank account opened by a firm) means: (a) if the account is opened at a branch in the United Kingdom: (i) the Bank of England; or (ii) the central bank of a member state of the OECD; or (iii) a bank; or (iv) a building society which offers, unrestrictedly, banking services; or (v) a bank which is supervised by the central bank or other banking regulator of a member state of the OECD; or (b) if the account is opened elsewhere: (i) a bank in (a); or (ii) [deleted] (iii) a bank which is regulated in the Isle of Man or the Channel Islands; or (c) a bank supervised by the South African Reserve Bank; or (d) any other bank that: (i) is subject to regulation by a national banking regulator; (ii) is required to provide audited accounts; (iii) has minimum net assets of £5 million (or its equivalent in any other currency at the relevant time) and has a surplus revenue over expenditure for the last two financial years; and (iv) has an annual audit report which is not materially qualified;
approved bank bond	means any instrument, by whatever name called, provided by an approved bank which - (a) provides for the immediate payment of a stated sum to the firm on demand whether by the firm or the FCA;

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

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

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

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

arranger — means a firm -

(a) whose sole investment business consists of activities within the following articles of the Regulated Activities Order -
(i) articles 14 (dealing in investments as principal) or 21 (dealing in investments as agent) if -
(aa) the firm is a venture capital firm; or
(bb) the activity is own account business which would be excluded from being investment business by the provisions of article 16 of the Regulated Activities Order but for the fact that the firm is an authorised person; or
(ii) article 25 (arranging deals in investments);
(iia) article 25DB (operating an electronic system for public offers of relevant securities);
(iii) article 37 (managing investments);
(iv) article 53 (advising on investments); and
(v) article 55A (providing targeted support);

(b) whose permission is subject to a limitation or requirement preventing it from holding money or property belonging to other persons and does not have a mandate over a customer's bank account;

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

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

associated business — means business which is carried on in connection with investment business;

bidding in emissions auctions — the regulated activity, specified in article 24A of the Regulated Activities Order (Bidding in emissions auctions), which is in summary the reception, transmission or submission of a bid at an auction of an emissions auction product conducted on an auction platform.

bonus — means that part of the remuneration paid by a firm to its employees (including directors) which is:

(a) not a profit share; and
(b) awarded by management entirely on a discretionary basis,

to the extent that it does not exceed the profit for the financial year of the firm before accounting for such bonus;

bought deal — means an offering where a firm on its own gives an outright binding commitment to the issuer or seller to purchase or subscribe for the securities to be offered;

broad scope firm — means any firm which is not an adviser or an arranger;

buy and sale back agreement — see reverse repurchase agreement;

call option	means an option to buy an investment, other instrument, foreign currency or physical commodity at a given price on or before a given date;
cap	means an agreement in respect of a borrowing under which a counterparty contracts to pay any interest costs arising as a result of an increase in rates above an agreed rate: the effect being to provide protection to the holder against a rise above that agreed rate;
certificate of deposit	means a negotiable or non-negotiable certificate issued by a bank;
client	means any person with or for whom a firm conducts or intends to conduct designated investment business or any other regulated activity; and: (a) every client is a customer or an eligible counterparty; (b) "client" includes: (i) a potential client; (ii) a client of an appointed representative of a firm with or for whom the appointed representative acts or intends to act in the course of business for which the firm has accepted responsibility under section 39 of the Act (Exemption of appointed representatives); (iii) a collective investment scheme even if it does not have separate legal personality; (iv) if a person ("C1"), with or for whom the firm is conducting or intends to conduct designated investment business, is acting as agent for another person ("C2"), either C1 or C2 in accordance with COBS 2.4.3R (Agent as client); (c) "client" does not include: (i) a trust beneficiary; (ii) a corporate finance contact; (iii) a venture capital contact.
client money rules	means CASS 4.1 to 4.3;
commissions shared	means that part of the remuneration paid by a firm which is determined on the basis of the number, size or profitability of individual deals carried out;
connected company	and "connected credit institution" mean, in relation to a firm which: (a) is a body corporate, a body corporate or credit institution satisfying any of the following conditions - (i) the same person is the controller of each body corporate or credit institution; (ii) if a group of two or more persons are controllers of each body corporate or credit institution and the group either consists of the same persons or could be regarded as consisting of the same persons by treating a member of either group as replaced by - (aa) that member's close relative; (bb) a person with whom that member is in partnership; or (cc) a body corporate of which the member is an officer; or (iii) both bodies corporate are members of the same group; or (b) is not a body corporate, a body corporate or credit institution which is controlled - (i) by the firm; (ii) by a partner in the firm; (iii) by a close relative of a partner in the firm or, if the firm is a sole trader, by a close relative of the sole trader; or (iv) collectively by any of the partners in the firm or their close relatives;
connected credit institution	see "connected company";
connected person	has the same meaning as given in sections 252, 253 and 254 of the Companies Act 2006 and a person described therein as being connected with a director will similarly be deemed to be connected with a partner of a firm;
contingency	means a future event the outcome of which is uncertain;
contingent liability	means a liability dependent upon the occurrence or non-occurrence of one or more

uncertain future events;

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

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

corporate finance business — means -

(a) *designated investment business* (other than *operating an electronic system for public offers of relevant securities* and *providing targeted support*) carried on by a *firm* with or for:
  (i) any issuer, holder or owner of designated investments, if that business relates to the offer, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, those investments, or any related matter;
  (ii) any eligible counterparty or professional client, or other body corporate, partnership or supranational organisation, if that business relates to the manner in which, or the terms on which, or the persons by whom, any business, activities or undertakings relating to it, or any associate, are to be financed, structured, managed, controlled, regulated or reported upon;
  (iii) any person in connection with:
    (A) a proposed or actual takeover or related operation by or on behalf of that person, or involving investments issued by that person (being a body corporate), its holding company, subsidiary or associate; or
    (B) a merger, de-merger, reorganisation or reconstruction involving any investments issued by that person (being a body corporate), its holding company, subsidiary or associate;
  (iv) any shareholder or prospective shareholder of a body corporate established or to be established for the purpose of effecting a takeover or related operation, where that business is in connection with that takeover or related operation;
  (v) any person who, acting as a principal for his own account:
    (A) is involved in negotiations or decisions relating to the commercial, financial or strategic intentions or requirements of a business or prospective business; or
    (B) (provided he is acting otherwise than solely in his capacity as an investor) assists the interests of another person with or for whom the firm, or another authorised person or overseas person, is undertaking business as specified in (a)(i),(ii),(iii) or (iv), by himself undertaking all or part of any transactions involved in such business;
  (vi) any person undertaking business with or for a person as specified in (a)(i), (ii), (iii), (iv) or (v) in respect of activities described in those sub-paragraphs;
(b) *designated investment business* carried on by a *firm* as a *principal* for its own account where such business:
  (i) is in the course of, or arises out of, activities undertaken in accordance with (a); and
  (ii) does not involve transactions with or for, or advice on investments or the *provision of targeted support* to, any other person who is a retail client in respect of such business;
(c) *designated investment business* carried on by a *firm* as *principal* for its own account if such business:
  (i) is in the course of, or arises out of:
    (A) the offer, issue, underwriting, repurchase, exchange or

redemption of, or the variation of the terms of, shares, share warrants, debentures or debenture warrants issued by the firm, or any related matter; or

(B) a proposed or actual takeover or related operation by or on behalf of the firm, or involving shares, share warrants, debentures or debenture warrants issued by the firm; or

(C) a merger, de-merger, reorganisation or reconstruction involving any shares, share warrants, debentures or debenture warrants issued by the firm; and

(ii) does not involve giving advice on investments or the *provision of* targeted support to any person who is a private customer;

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

counterparty — means any person with or for whom a firm carries on, or intends to carry on, any regulated business or associated business;

CRR — means the counterparty risk requirement, as calculated in 3-170 to 3-182;

customer — means a client who is not a eligible counterparty;

dealing activities — means all dealing activities as principal or agent in investments and physical commodities;

dematerialised instruction transmitter — means a firm -

(a) which restricts its investment business to activities within article 45 (sending dematerialised instructions) of the Regulated Activities Order; and

(b) which does not hold or receive money or property belonging to another person nor has a mandate over another person's bank account;

derivative fund manager — means an arranger -

(a) whose investment business consists of discretionary management of funds which are invested predominately in derivatives; and

(b) whose income is not related to the volume of business transacted on behalf of the funds managed by him;

documents of title — means documents of title and documents evidencing title to investments and commodities;

domestic offering — means an offering or a tranche of an offering which is directed primarily to investors in the United Kingdom and which uses methods normal in the United Kingdom domestic capital markets;

dual currency bonds — means debt securities, the issue price and coupon of which are fixed in one currency whilst the redemption value is fixed in a different currency;

eligible capital substitute — means a subordinated loan, approved bank bond or approved undertaking which a firm may treat as an eligible capital substitute in accordance with rule 3-63;

employee — in relation to any person, means an individual -

(a) who is employed by that person under a contract of service, a contract for services, or any other contract under which the individual will provide services to the person;

(b) who is a director of the person where the person is a body corporate;

(c) who is a partner of the person where the person is a partnership;

(d) who, where the person is an unincorporated association, is a member of its governing body, the secretary or treasurer; or

(e) whose services are, under an arrangement between the person and a third party, placed at the disposal and under the control of the person;

equity balance — means -

(a) a counterparty's equity balance; or

(b) a firm's equity balance;

exceptional items — means those items which derive from events or transactions within the ordinary activities of the business of a firm and which are both material and not expected to

	recur frequently or regularly;
exchange	means a recognised investment exchange or designated investment exchange;
exchange traded	means an investment which is traded or listed on exchange or on an approved exchange; or an offering where an investment pari passu to that being offered is traded or listed on exchange or on an approved exchange;
ex-change-traded-margined-transaction	means a margined transaction effected by a firm under the rules of an exchange or an approved exchange or clearing house;
exempt MiFID commodities firm	a firm to which the exemption in Schedule 3 paragraph 1(k) to the RAO applies.
extraordinary items	means those items which derive from events or transactions outside the ordinary activities of the business of a firm and which are both material and not expected to recur frequently or regularly;
financial bookmaker	means a firm which conducts only spread-betting business;
financial reporting statement	means the periodic financial and other reporting statements required to be provided to the FCA under the provisions of Chapter 16 of the Supervision manual;
financial resources financial resources re-quirement	means the sum of the firm's tangible net worth and eligible capital substitutes; means the sum of the firm's primary requirement, PRR and CRR;
financial rules	means the financial rules in Chapter 3 of the FCA's Interim Prudential Sourcebook for Investment Businesses (IPRU(INV)3);
floor	means an agreement in respect of a deposit under which a counterparty contracts to pay any lost income arising as a result of a fall in rates below an agreed rate: the effect being to provide protection to the holder against a fall below that agreed interest rate;
foreign currency derivatives method	means the method of calculating PRR under rule 3-153;
foreign currency exposures method	means the method of calculating PRR under rule 3-154;
forward	means a security which is transacted for a settlement date beyond that which would normally apply in the market concerned, and where that forward settlement date is not yet passed;
FRA	means forward rate agreement, i.e. an agreement in which two parties agree on the payment by one party to another of an amount of interest based on an agreed interest rate for a specified period from a specified settlement date applied to an agreed principal amount; no commitment is made by either party to lend or borrow the principal amount; their exposure is only the interest difference between the agreed and actual rates at settlement;
free delivery	means - (a) the delivery of securities or physical commodities which takes place before the seller receives payment; or (b) payment made in settlement of a credit balance arising from a sale on behalf of, or a purchase from a counterparty in respect of which the securities are undelivered;
FRN	means floating rate note, i.e. all debt securities which pay interest at a rate which varies in response to general interest rates (including floating rate collateralised mortgage obligations);
in the money	means, in relation to call options and warrants, that the exercise price is less than the current mark to market value of the underlying instrument and, in relation to put options, that the current mark to market value is less than the exercise price;
initial margin requirement	means the total amount which under the rules of the relevant exchange or exchanges or clearing house or clearing houses the firm or an intermediate broker would be required to deposit in cash as a fidelity deposit in respect of all the client's open positions in margined transactions at that time, irrespective of any unrealised profit or loss on such positions, on the assumption that those transactions were the only transactions undertaken under the rules of that exchange or those exchanges or that clearing house or those clearing houses by the firm or the intermediate

broker at that time;

intermediate broker — in relation to a margined transaction, means any person through whom the firm undertakes that transaction;

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

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

investment — means a designated investment;

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

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

(a) dealing in investments as principal (article 14), but disregarding the exclusion in article 15 (Absence of holding out etc);
(b) dealing in investments as agent (article 21);
(ba) auction regulation bidding (part of bidding in emissions auctions) (article 24A);
(c) arranging deals in investments for another person (article 25(1)) but only in relation to investments;
(d) making arrangements for deals in investments (article 25(2)) but only in relation to investments;
(da) operating an electronic system for public offers of relevant securities (article 25DB);
(e) managing investments (article 37);
(f) safeguarding and administration of assets (article 40);
(g) sending dematerialised instructions (article 45(1));
(h) causing dematerialised instructions to be sent (article 45(2));
(i) [deleted]
(ia) managing a UCITS (article 51ZA);
(ib) acting as trustee or depositary of a UCITS (article 51ZB);
(ic) managing an AIF (article 51ZC);
(id) acting as trustee or depositary of an AIF (article 51ZD);
(ie) acting as a residual CIS operator (article 51ZE);
(j) [deleted]
(k) [deleted]
(l) advising on investments (article 53);
(la) providing targeted support (article 55A);
(j) agreeing to carry on the activities in (a) to (h) and (l) (article 64);[i]

investment manager — means a person who, acting only on behalf of a customer, either -

(a) manages an account or portfolio in the exercise of discretion; or
(b) has accepted responsibility on a continuing basis for advising on the composition of the account or portfolio;

investment services — means -

(a) activities undertaken in the course of carrying on investment business; and
(b) activities undertaken in connection with an ISA where those activities do not constitute investment business;

launch — means the time when any announcement, specifying the issuer or the guarantor of and indicating the final pricing terms of the offering is made for the first time to the public or the press or any exchange or approved exchange or information service;

margin requirement — means, in relation to a counterparty, the value of any amounts which the firm or intermediate broker would be required to pay under the rules of an exchange or clearing house to -

(a) meet any marked to market losses occurring on contracts undertaken for that counterparty at that time; or
(b) as an initial margin fidelity deposit in respect of all the counterparty's

open positions at that time,

on the assumption that those transactions were the only transactions undertaken on the exchange or clearing house by the firm or intermediate broker at that time;

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

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

marketable investment — means -

(a) an investment which is traded on or under the rules of an exchange or an approved exchange;

(b) a debt instrument which may be transferred without the consent of the issuer or any other person (including a collateralised mortgage obligation);

(c) a physical commodity;

(d) a warrant, option, future or other instrument which entitles the holder to subscribe for or acquire -

(i) an investment or physical commodity which falls under (a) to (c) above;

(ii) any currency; or

(iii) any combination of (i) and (ii) above;

(e) a contract for differences (including interest rate and currency swaps) relating to fluctuations in -

(i) the value or price of an investment or physical commodity in (a) to (d) above;

(ii) any currency;

(iii) the rate of interest in any currency or any index of such rates;

(iv) the level of any index which is derived from the prices of an investment or physical commodity in (a) to (c) above; or

(v) any combination of (i) to (iv) above;

(f) warrants, options, futures or other instruments entitling the holder to obtain the rights of those contracts in (d) or (e) above; and

(g) a unit in a regulated collective investment scheme;

model A clearing firm — means a regulated clearing firm which uses its own money for settlement but is reimbursed on a daily basis by the non-clearing firms it settles for;

money broker — means a firm for which the total value of repurchase, securities lending and sale and buy back agreements is or has been at any time during the previous year, at least 25% of its total assets;[ii]

new securities — means, in relation to a particular offering, securities which are issued pursuant or with a view to an offering;

new to the market — means, in relation to an offering, securities which are not already exchange traded;

non clearing floor member — means a firm which:

(a) is authorised to trade on the floor of a recognised investment exchange which permits this category;

(b) is not prohibited by the rules of that exchange from dealing with customers;

(c) has entered in to an agreement with a clearing firm which accepts full responsibility for every deal entered into by the non clearing floor member; and

(d) is not authorised to handle client money;

non recourse loan — means a loan to a firm secured on specific land or buildings, under the terms of which the lender has no claim on the other assets of the firm nor on assets for which the firm is accountable in any circumstances (including a winding up);

note issuance facility — means an arrangement under the terms of which a borrower is able to issue short

	term notes in its own name with a guarantor, or consortium of guarantors ensuring the availability of funds to the borrower by agreeing to purchase any unsold notes, and which includes for example revolving underwriting facilities, note purchase facilities, euronote facilities and similar arrangements;
offering	means an offering of securities which are - (a) issued for the purpose of the offering; (b) new to the market; or (c) existing securities which are exchange traded subject to the purchase of those securities having the same characteristics as an offering of new securities, or securities which are new to the market;
open-priced deal	means an international offering which is not a bought deal or pre-priced deal;
option	(for the purposes of rule 3-173B) means a contract which confers the right to buy or sell a security, contractually based investment, currency, gold or commodity at a given price on or before a given date. (NB: the definition of an option used for this purposes deliberately differs from that in the main Handbook Glossary);
out of the money	means those options and warrants which are not in the money;
pari passu security	means a security which is the same as another security, except only in respect of payment, entitlement to initial dividend and the nature of documents of title; passported institution means an incoming EEA firm;
percentage risk addition	means a percentage to be applied to the value of positions in investments held by the firm to determine its PRR;
perfectly matching contracts	mean certain OTC derivatives contracts which are included in a legally binding netting agreement that are equal and exact opposites and perfectly matching in all material respects;
physical commodities method	means the method of calculating PRR under rules 3-166 to 3- 169B;
physical commodity	means the actual commodity, documents of title to actual commodities or shipping documents conveying title to actual commodities;
preference security	means a share with rights, in respect of capital or dividends, superior to those of ordinary equity;
pre-priced deal	means an international offering other than a bought deal all the pricing terms of which have been fixed;
pricing terms	means, in relation to an offering, the amount of currency, maturity, offering price, rate of or means of calculating interest and any prices at which securities may be redeemed or converted or exchanged into other securities;
primary requirement	is the primary requirement calculated in accordance with Table 3-61;
profit share	means an appropriation of profit before tax on a predetermined basis for the benefit of management or employees;
property fund	means a scheme dedicated to permitted immovables and property related assets, whether with or without other transferable securities;
PRR	means the position risk requirement of a firm as calculated in accordance with rules 3-80 to 3-169B;
put option	means an option to sell an investment, other instrument, foreign currency or physical commodity at a given price on or before a given date;
qualifying debt security	means a debt security which: (1) (other than for the purposes of rule 3-173B): (a) represents or evidences indebtedness; (b) is a marketable investment; (c) if it or "equivalent debt" is rated by a "relevant agency" (and there has been no announcement that the rating will be cancelled) - (i) the security or the "equivalent debt" is so rated at or higher than the level indicated in the table in **Appendix 34**; (ii) there has been no announcement that the rating will be down-graded below the level so indicated; and (iii) the firm has no reasonable cause to believe that another

"relevant agency" has rated the security or "equivalent debt" below the level so indicated; and

(d) if neither it nor any "equivalent debt" is rated by a "relevant agency" (or there has been an announcement that such a rating will be cancelled), it satisfies one or more of the following -

(i) it is issued or guaranteed by or is subject to the full faith and credit of a sovereign government or province or state thereof (or a corporation over 75% owned by such sovereign government, or province or state), which is a member of the OECD and the government, province, state or corporation has not defaulted, or entered into any rescheduling or similar arrangement, or announced the intention of so doing, in respect of itself or its agency's debt within the last five years;

(ii) it is issued or guaranteed by a supranational organisation;

(iii) it is issued or guaranteed by a corporation (not being a bank, for which see (iv) below) the ordinary shares of which are included within the following categories -

(aa) UK : constituents of the FT All Share Index;

(bb) Japan : constituents of the First Section of the Tokyo Stock Exchange;

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

(dd) countries listed below: the constituents of the FTThe
Actuaries World Indices in respect thereof;
Australia
Belgium
Canada
Denmark
France
Germany
Hong Kong
Italy
Netherlands
Norway
Singapore
Spain
Sweden
Switzerland

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

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

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

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

(a) in respect of any security of, or guaranteed by, any issuer or

guarantor, "equivalent debt" means any debt which ranks pari passu with, or subordinate to, the security or (as the case may be) the guarantee; and

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

(3) (for the purposes of rule 3-173B) meets the following conditions:

(a) it attracts zero specific risk under Table 2 in **Appendix 47**; or

(b) it is issued by, or fully guaranteed by:

(i) a Zone B central government or central bank and the security is denominated in the local currency of the issuer;

(ii) a multilateral development bank;

(iii) a Zone A public sector entity;

(iv) a company whose share is a constituent of one of the indices making up the FTSE All-World Index; or

(v) an issue of, or fully guaranteed by an investment firm or recognised third-country investment firm; or

(c) it is issued by, fully guaranteed by, endorsed or accepted by:

(i) a credit institution incorporated in a Zone A country; or

(ii) a credit institution incorporated in a Zone B country and the debt security has a residual maturity of one year or less; or

(d) [deleted]

(e) it is rated by at least one of the agencies shown in Table 3 Appendix 47, and every such rating equals or exceeds the corresponding minimum shown in that table;

qualifying deposit

means a deposit which is one of the following -

(a) balance on current account with an approved bank;

(b) money on deposit with an approved bank, United Kingdom local authority, member of the Finance Houses Association, stock exchange moneybroker, regulated clearing firm, the National Savings Bank, exchange, approved exchange or approved depository which may be withdrawn within three months;

(c) money on deposit with an approved bank directly related to a transaction creating an offsetting liability for the firm or subject to an agreement with the bank allowing its use as collateral for a loan that may be withdrawn within three months, which relates to a liability of the same maturity and arises out of a transaction;

(d) amount evidenced by a certificate of tax deposit;

(e) amount evidenced by a certificate of deposit issued by a regulated banking institution which matures within three months; or

(f) deposit of cash by way of margin with an exchange, approved exchange, clearing house or intermediate broker;

regulated banking institution

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

regulated business

means investment business which is

(a) business carried on from a permanent place of business maintained by a firm (or its appointed representative) in the United Kingdom; and

(b) other business carried on with or for customers in the United Kingdom, unless that business is -

(i) business carried on from an office of a firm outside the United Kingdom which, if that office were a separate person, would fall

	within the overseas persons exclusions set out in article 72 of the Regulated Activities Order; or (ii) business of an appointed representative of the firm which is not carried on in the United Kingdom;
regulated clearing firm	means a clearing firm which is an authorised person;
regulated financial institution	means a firm, or an institution which is authorised to conduct investment business involving the execution of transactions on exchanges or on securities or derivatives exchanges by one or more of the following regulators - (a) any regulator of investment business in any member state of the EU (other than the United Kingdom) established by law in that state; or (b) a body referred to in Part 1 of **Appendix 35**; provided, in the case of any such institution that the firm has no reason to suppose that the institution is in breach, in any material respect, of the rules enforceable by the relevant regulator;
relevant annual expenditure	means the relevant annual expenditure of a firm calculated in accordance with rule 3-73;
reporting statement	means any one or more of the following types of report as required by the Supervision manual: (a) audited annual financial statements; (b) annual reporting statement; (c) [deleted]; (d) internal control letter; (e) quarterly reporting statement; (f) position risk reporting statement; (g) counterparty risk reporting statement; (h) annual reconciliation; (i) monthly reporting statement; and (j) the audited accounts of a subsidiary of the firm;
repurchase agreement	(and sale and buy back agreement) means an agreement for the sale of securities or physical commodities subject to a commitment to repurchase from the same person the same or similar securities or physical commodities;
reverse repurchase agreement	(and "buy and sale back agreement") means an agreement for the purchase of securities or physical commodities subject to a commitment to resell to the same person the same or similar securities or physical commodities;
Sale	includes any disposal for valuable consideration;
sale and buy back agreement	see repurchase agreement;
scheme management activity	[deleted]
settlement day	means the day on which under the recognised practice of an exchange or approved exchange, bargains are contracted for settlement; and in the case of bargains not transacted on an exchange or approved exchange, or entered into for forward settlement, 20 days from the date of the transaction, or, if earlier, the contractual due date;
stock exchange moneybroker	is a moneybroker which is an authorised person and acts as an intermediary in the gilt market;
supranational organisation	means any organisation referred to in Part 2 of **Appendix 35**;
swap	means a transaction in which two counterparties agree to exchange streams of payments over time according to a predetermined basis;
takeover or related operation	means: (a) any offer to which the Takeover Code applies and any transaction or arrangement which is of such a nature that the Takeover Code would have applied to it had it concerned a company whose shares are listed under Part VI of the Act and whose head office and place of central management are in

	the United Kingdom; (b) any offer, transaction or arrangement relating to the purchase of securities with a view to establishing or increasing a strategic holding of a person, or of a person together with his associates in the securities concerned; (c) any transaction or arrangement entered into in contemplation or furtherance of any offer, transaction or arrangement falling within (a) or (b) above; and (d) any transaction or arrangement entered into by way of defence or protection against any offer, transaction or arrangement falling within (a), (b) or (c) above which has taken place or which is contemplated;
tangible net worth	is the tangible net worth of a firm calculated in accordance with rule 3-62;
total PRR	means the sum of all the amounts calculated as a PRR under rules 3-80 to 3- 169B;
traditional option	means any option arranged but not traded under the rules of the London Stock Exchange;
trust beneficiary	means a beneficiary under a trust (not being the settlor) who benefits from the performance by a firm as trustee of investment services relating to the management of the trust assets;
underwriting	means a commitment to take up securities where others do not acquire or retain them;
underwriting price	means the price at which the firm is committed to take up the securities or the price at which it is committed to do so if required under the underwriting commitment less any commissions or discounts paid or allowed in connection with the transaction, except to the extent that the firm has taken credit for them in its accounts;
variable rate note	means a debt security with the characteristics of an FRN except that the margin with respect to the index rate of interest is subject to variation depending on periodic negotiations;
variation margin requirement	means in relation to a counterparty the value of any amounts which the firm or intermediate broker would be required to pay under the rules of an exchange, approved exchange or clearing house to meet any marked to market losses occurring on contracts undertaken for that counterparty at that time on the assumption that those transactions were the only transactions undertaken on the exchange, approved exchange or clearing house by the firm or intermediate broker at that time;
venture capital schemes	means a scheme for providing capital to a body corporate whose equity is not traded or listed on an exchange;
walkaway clause	means a provision which permits a non-defaulting counterparty to make only limited payments, or no payment at all, to the estate of the defaulter, even if the defaulter is a net creditor;
warrant fund	means a scheme which is dedicated to transferable securities except that it is permitted to invest entirely in warrants;
zone A	see definition of Zone A country in the Glossary; and
zone B	means any country not in Zone A.

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

[ii] For guidance notes on money brokers, see **Appendix 37**.

APPENDIX 20: GUIDANCE NOTES ON RECONCILIATION OF FIRM'S BALANCES WITH A COUNTERPARTY WHICH IS A MEMBER OF AN EXCHANGE (RULE 3-11(1)(D)) AND IPRU(INV) 9.6.1R (FOR AN EXEMPT CAD FIRM)) [deleted]

APPENDIX 21: GUIDANCE NOTES ON THE VALUATION OF POSITIONS (RULE 3-41(9))

INTRODUCTION

1

Rule 3-41(9) states that a position must be valued at its close out price, where close out price means that a long position should be valued at current bid price and a short position at current offer price. In addition, rule 3-41(9) states that a firm must value a position on a prudent and consistent basis, and have regard to the liquidity of the instrument concerned and any special factors that may adversely affect the closure of the position.

2

The following paragraphs give general indications to firms on the appropriate valuation methodology. However, it is emphasised that prudence should be the overriding influence in the valuation exercise and that, where uncertainty exists as to the most appropriate price, the firm should use that price which gives the most conservative valuation.

GENERAL PRINCIPLES

3

Firms should value positions by reference to market prices, but where necessary should add a prudent and appropriate buffer to the bid or offer price to account for factors which would adversely affect the firm's ability to realise the close-out value, such as -

(a) the liquidity of the security in question;
(b) the size of the position held in that security relative to the sizes at which prices are quoted;
(c) the direction of the position (long or short) relative to the current direction of the market;
(d) the exposure of the firm to the relevant market as a whole;
(e) any conversion or foreign exchange costs that would be incurred if the position were closed out;
(f) any other factors which may affect the close-out price.

4

Where a mid-market or single price only is available for the security in question, firms must adjust this price by a prudent and appropriate buffer as outlined in paragraph 3 above.

5

With respect to paragraphs 3 and 4 above, firms should be able to demonstrate at all times how they determined the final price applied to any position in a security.

APPENDIX 26 (RULES 3-81 TO 3-165): SUMMARY TABLES OF WHICH METHOD OF PRR TO APPLY TO AN INSTRUMENT

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

APPENDIX 33 (EXCHANGES): LIST OF APPROVED EXCHANGES

The following exchanges are approved for the purposes of the definition of "approved exchange" -

Athens Stock Exchange (ASE)
Barcelona Stock Exchange (Bolsa de Valores de Barcelona)
Belgian Futures & Options Exchange (BELFOX)

Berlin Stock Exchange (Berliner Börse)
Bilbao Stock Exchange (Bolsa de Valores de Bilbao)
BVLP (Bolsa de Valori de Lisbao e Porto
Bolsa de Mercadorios & Futures (BM&F)
Boston Stock Exchange
Bovespa (The São Paulo Stock Exchange)
Bremen Stock Exchange (Bremer Wertpapierbörse)
BVRJ (The Rio de Janeiro Stock Exchange)
Cincinnati Stock Exchange
Copenhagen Stock Exchange (Kobenhavns Fondsbors)
Dusseldorf Stock Exchange (Rheinisch-Westfälische Börse zu Düsseldorf)
Frankfurt Stock Exchange (Frankfurter Wertpapierbörse)
Hannover (Niedersächsische Börse zu Hannover)
Italian Exchange
Kuala Lumpur Stock Exchange
Luxembourg Stock Exchange (Société de la Bourse de Luxembourg SA)
Madrid Stock Exchange (Bolsa de Valores de Madrid)
Mercato Italiano Futures (MIF)
Munich Stock Exchange (Bayerische Börse in München)
Nagoya Stock Exchange
New Zealand Stock Exchange
Oslo Stock Exchange (Oslo Bors)
Stuttgart Stock Exchange (Baden-Würtembergische Wertpapierbörse zu Stuttgart)
Swiss Exchange (SWX)
Taiwan Stock Exchange
Tel Aviv Stock Exchange
The Stock Exchange of Thailand
Valencia Stock Exchange (Bolsa de Valores de Valencia)

APPENDIX 34 ("QUALIFYING DEBT SECURITY"): RELEVANT AGENCY

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

		Securities minimum category	**Money market obligations minimum category**
1	**For all issuers** Moody's Investors Service Standard and Poor's Corporation Fitch Ratings Ltd	 Baa3 BBB BBB	 P3 A3 A3
2	**For all banks, Building Societies and parent companies and subsidiaries of banks** Thomson BankWatch	 BBB-	 TBW-3
3	**For Canadian issuers and issues in Canadian dollars** Canadian Bond Rating Service Dominion Bond Rating Service	 B++low BBB low	 A-3 R-2
4	**For Japanese issuers and issues in Japanese yen**		

	Fitch Ratings Ltd Japan Credit Rating Agency, Ltd Japan Rating and Investment Information, Inc Mikuni & Co Ltd	BBB- BBB- BBB- BBB	F-3 J-2 a-2 M-3
5	**For United States issuers and issues in US dollars** Fitch Ratings Ltd	 BBB-	 F-3

APPENDIX 35 ("REGULATED FINANCIAL INSTITUTION" AND "SUPRANATIONAL ORGANISATION"): LIST OF REGULATED FINANCIAL INSTITUTIONS AND SUPRANATIONAL ORGANISATIONS

PART 1LIST OF REGULATORS FOR THE PURPOSES OF THE DEFINITION OF REGULATED FINANCIAL INSTITUTION

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

PART 2 LIST OF SUPRANATIONAL ORGANISATIONS

a multilateral development bank;
The Bank for International Settlements;
The Council of Europe;
Euratom (The European Atomic Energy Community);
Eurofima (The European Company for Financing of Railroad Rolling Stock);
The EU;
The International Monetary Fund;

APPENDIX 37 (RULE3-177): GUIDANCE NOTES FOR MONEY BROKERS APPLICATION OF THE COUNTERPARTY RISK REQUIREMENT

INTRODUCTION

1

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

CALCULATION OF 0.5% ADDITIONAL CRR

2

A money broker should calculate the additional CRR requirement as follows -

(a) if a money broker is satisfied that it has a legal right to net off exposures with an individual counterparty, valid and enforceable in the United Kingdom or any other relevant country, it may do so in accordance with the rule 3-176(3). The obligation rests with the broker to demonstrate that the method it uses is reasonable and justifiable. It is stressed that this right to net is at the option of the firm and is not mandatory;

(b) a money broker should then aggregate its total level of securities subject to a repurchase or reverse repurchase agreement, securities lending or borrowing agreement and sale and buy back or buy and sale back agreement (either net or gross) to or from individual counterparties outside an approved payments system and money lent against Talisman short-term certificates. A capital requirement of 0.5% of this sum should then be calculated.

APPROVED PAYMENTS SYSTEMS

3

The following are approved payment systems when the systems concerned provide for settlement on a delivery versus payment basis -

- Austraclear New Zealand
- Banca D'Italia's Giornaliera
- Banque Nationale de Belgique
- Bank of Spain Interbank Bond Settlements System
- Banque de France's SATURNE
- BOJ-NET DVP
- Central Gilts Office
- Clearstream
- Depository Trust Company
- Euroclear
- Fedwire - see The Federal Reserve System
- Kassenverein
- Necigef
- SICOVAM (Relit settlement only)
- Sociedad de Compensacion y Liquidacion de Valores
- The Canadian Depository for Securities Ltd
- The Federal Reserve System (Fedwire), and
- Vardepapperscentralen VPC AB

COLLATERAL

4

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

APPENDIX 43: GUIDANCE NOTES ON THE FINANCIAL RESOURCES AND ACCOUNTING TREATMENT OF SOFT COMMISSION AGREEMENTS (RULES 3-73 AND 3-182(3))

INTRODUCTION

1

This Appendix contains detailed guidance to the following rules-

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

2

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

3

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

DEFINITION

4

A soft commission agreement means-

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

DESCRIPTION

5

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

6

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

EXISTING DIFFERENCE IN ACCOUNTING POLICIES

7

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

8

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

EXPENDITURE AND BALANCES RECEIVABLE

9

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

REQUIRED TREATMENT

10

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

11

Notwithstanding the above, expenditure may be capitalised (as an asset) in the balance sheet of the company which incurred the expenditure, only where this amount is recoverable under a legally enforceable contract (see paragraph 18 below). Where such expenditure is capitalised it will be subject to rule 3-182(3).

INCOME AND BALANCES PAYABLE

12

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

REQUIRED TREATMENT

13

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

EXPENDITURE REQUIREMENT

14

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

REQUIRED TREATMENT

15

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

16

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

17

It is considered that certain firms may have been under the misapprehension that there was a concession for all expenditure related to "soft commission agreements" regardless of whether the agreement was legally enforceable. Where a firm undertakes a mixture of business between legally enforceable contracts and informal arrangements (all of which the firm would classify as "soft commission agreements"), it must take great care in allocating expenditure between legally enforceable contracts and others. Alternatively, it may decide to include all expenditure in the expenditure requirement regardless of source.

LEGALLY ENFORCEABLE CONTRACTS

18

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

APPENDIX 46 (TABLE 3-173(2)B): COUNTRIES/TERRITORIES IN WHICH CRR ON ISSUING MARKET FREE DELIVERIES MAY BE RELAXED

INTRODUCTION

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

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

Appendix 47: Tables applicable to CRR for derivative transactions under the rule 3-173B

TABLE 1

Counterparty Weights to be Applied in Calculating Liquidity Adjustment and CRR (rule 3- 173B(5)(b))

Type of counterparty	Counterparty weight
claims on, or explicitly guaranteed by, or collateralised with securities issued by: - the central government or central bank of a Zone A country; - the EU or Euratom (the European Atomic Energy Community); or - any other government or central bank, provided the exposure is denominated in that country's national currency.	NIL
claims on discount houses, gilt-edged market makers, institutions with a money market dealing relationship with the Bank of England and those Stock Exchange money brokers which operate in the gilt-edged market, where the claims are secured on gilts, UK Treasury bills, eligible local authority and eligible bank bills, or London CDs	10%
claims on, or explicitly guaranteed by: - a multilateral development bank; - the regional government or local authority of a Zone A country; - a Zone A credit institution; - a recognised clearing house or recognised exchange; - a recognised third country or EEA investment firm; - a Zone B credit institution, provided the exposure has a maturity of one year or less.	20%
any other counterparty	100%

Guidance

The guarantee should be explicit and be legally enforceable by the firm and should prevent a firm's capital from becoming deficient as a result of experiencing a loss on such an exposure. The exposure must be retained on the firm's balance sheet.

TABLE 2

Specific risk percentage risk additions

Issuer	Residual maturity	Percentage risk addition
An issue of, or fully guaranteed by, or fully collateralised by a Zone A central government or central bank or the EU or Euratom (the European Atomic Energy Community)	Any	0%
An issue of, or fully guaranteed by, a Zone B central government or central bank denominated in the local currency	Zero to 12 months	0%

TABLE 3

Minimum ratings for qualifying debt securities

Issuer	Rating agency	Minimum rating	
		Securities	**Money Market Obligations**
Any	Moody's Investors Service Baa3 Standard & Poor's Corporation BBB FITCH Ratings Ltd	P3 A3 BBB	 F-3
Canadian	Canadian Bond Rating Service Dominion Bond Rating Service	B++low BBB low	A-3 R-2
Japanese	Japan Credit Rating Agency, Ltd Mikuno & Co Japan Rating & Investment Information Inc	BBB- BBB BBB-	J-2 M-3 a-2

APPENDIX 56: GUIDE TO ADEQUATE CREDIT MANAGEMENT POLICY (ACMP) (RULES 3-73 TO 3-175, 3-300 AND "ACMP")

INTRODUCTION

1

This appendix contains general guidance on the standards which the FCA expects a firm's ACMP to meet.

OBJECTIVE

2

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

SCOPE

3

The guidance applies to any firm which wishes to take advantage of the lower CRR percentages (by which counterparty exposures must be multiplied).

4

Before a firm may use the lower percentages in calculating CRR and in preparing its financial reporting statements, it must meet the requirements set by 3-300. The ACMP and its operation will be reviewed periodically by the FCA and, where it is no longer operating effectively, the firm may be in breach of those requirements.

BACKGROUND

5

The FCA is aware that firms grant credit to counterparties in many different ways, including for example, loans to cover actual margin calls as a result of delays between trade date and final settlement or of late settlement etc. This guidance is designed to cover all instances where a firm becomes exposed to credit risk although, depending on the way in which credit risk arises, the procedures for managing it may differ.

6

In considering the credit management policies of a firm, the FCA will expect the firm to operate a robust control structure which is appropriate to the size, scale and nature of its business and the diversity and complexity of its exposures. The FCA recognises that different approaches to and styles of credit management can create an effective operational control environment. Therefore, it is not appropriate for the FCA to lay down prescriptive standards which it would expect a firm to meet, but rather to suggest a broad framework which is flexible, allows for individualised solutions and can accommodate and encourage evolutionary developments.

7

The prime components of a sound credit risk management process are:

- the definition by a firm of what constitutes a credit exposure/risk and is therefore covered by the firm's ACMP;
- a comprehensive credit risk measurement approach;
- the existence of guidelines and other parameters used to determine credit limits and govern the level and types of risk taken; together with
- a strong management information system for controlling, monitoring and reporting exposures.

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

8

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

GENERAL PRINCIPLES

9

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

Role of senior management

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

Procedures

(b) whether there are clearly established lines of responsibility and levels of authority for:

- the granting of credit to a counterparty;
- extending its permitted use to cover risk arising on a product new to the counterparty;
- increasing existing credit facilities; and
- the monitoring and controlling of all credit risk;

(c) the extent to which the functions of granting, measuring, monitoring and controlling credit risk are managed independently of the front office with a direct reporting line to the senior management ultimately responsible for credit risk management;

(d) whether good channels of communication exist which ensure that the firm's credit management procedures are well understood and followed by all relevant personnel;

(e) whether procedures exist for identifying unintentional credit exposures and dealing with counterparty which has failed to settle its obligations to the firm,(whether merely due to a delay or actual default), or which is expected not to settle its obligations on the due date; including arrangements for closing out transactions. In addition, the FCA may consider whether a firm has the ability to identify and attempt to predict, as well as quantify, any shortfall as it arises and on an aged basis;

(f) whether mechanisms exist for a daily comparison of exposures with credit limits, including the production of exception reports, and the procedures to be followed to deal with the results of those exception reports;

Documentation

(g) whether a firm's credit management policies and procedures are properly documented and reviewed by the firm on a regular and thorough basis to ensure that they continue to remain appropriate and sound;

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

Collateral and margin

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

Measurement and monitoring of exposures

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

(k) where a firm uses risk reduction techniques (such as master agreements, netting agreements, collateralisation arrangements or the taking of third party credit enhancements, including letters of credit and guarantees), whether the firm has procedures for scrutinising documents and assessing their impact on the credit risk of the firm and assessing the quality of any guarantees or letters of credit;

(l) depending on the nature of the credit exposures to which a firm is subject, whether the firm's mechanisms for measuring such exposures are appropriate to cover the type or level of risk to which they give rise.

ADDITIONAL GUIDANCE ON THE FCA'S ASSESSMENT OF ACMPS

PREAMBLE

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

A DEFINITION OF CREDIT AND THE MEASUREMENT OF CREDIT RISK

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

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

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

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

THE DECISION TO GRANT CREDIT

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

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

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

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

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

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

Cover sheet detailing proposed credit.

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

Financial information on proposed counterparty.

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

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

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

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

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

- Industry exposure
- Country exposure
- Spread of counterparties - large exposures

THE MONITORING OF CREDIT EXPOSURES

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

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

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

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

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

COMPUTER SYSTEMS

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

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

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

REPORTING

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

- Excess reports/Exception reports
- Exposure reports
    - by customer/group/connected customers
    - by industry
    - by country
- Overdue payments reports

- Facilities due for review
- Facilities by collateral/security type
- Collateral/security held
- Large Exposures

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

CREDIT RISK MANAGEMENT/CONTROL

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

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

DOCUMENTATION

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

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

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

Basic documentation to be obtained from all counterparties might include

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

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

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

Other areas for consideration could include:

- Prompt execution of documentation
- Monitoring response to documents sent out
- Chasing where no response

- Reporting missing documentation to senior management
- Proper execution
- Secure storage of documentation
- Regular review of documentation held

ONGOING REVIEW OF CREDIT RISK

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

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

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

DOCUMENTATION OF CREDIT POLICIES AND PROCEDURES AND CUSTOMER FILES

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

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

APPENDIX 62: NETTING

SIMILAR TYPES OF TRANSACTIONS

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

DERIVATIVE TRANSACTIONS

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

GUIDANCE ON THE NETTING OF COUNTERPARTY EXPOSURES

INTRODUCTION

1.

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

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

SCOPE

2.

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

BACKGROUND

3.

Agreements which can effect set-off of counterparty exposures exist in two forms:

(a) novation agreements (referred as netting by novation) which replace existing contracts with one new contract and therefore can only be used to cover similar transactions with payments in the same currency for the same value dates;and
(b) netting agreements which can be used to cover transactions of very different types.

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

PRINCIPLES OF OFFSET

4.

Before offsetting exposures in similar types of transactions with a counterparty a firm must have a contractual netting agreement with that counterparty which:

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

PRINCIPLES OF OFFSET

5.

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

6.

As mentioned above mutuality is required in order for there to be complete set-off of transactions. Accordingly, firms are expected to have procedures in place to identify the counterparty and the capacity in which the counterparty is acting. Firms proposing to rely on the Statement of Law on netting must satisfy themselves of the appropriateness of such reliance and,where in doubt, obtain legal advice. It is important to note that Insolvency Rule 4.90 does not apply to building societies, statutory organisations generally, mutual societies, partnerships and individuals.

LEGAL REQUIREMENTS

7.

Legal opinions will be needed for the:

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

8.

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

9.

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

10.

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

11.

As mentioned above legal opinions should relate to the law of the jurisdiction in which the counterparty is organised (i.e.incorporated or resident). However,certain circumstances may arise where this requirement could be considered not to be applicable; for example where:

- a firm has no assets or exposure in that jurisdiction;
- any judgement obtained in that jurisdiction against a firm would not be enforceable under any of the rules in the UK relating to the enforcement of foreign judgements; or
- there are no other factors relating to that jurisdiction which would affect the ability of a firm to make net payments as contemplated by the netting agreement.

12.

Where a firm believes that the law of the jurisdiction in which a counterparty is organised is not relevant, that point must be addressed in the legal opinion supporting the netting agreement. The ability to exclude the law of the jurisdiction in which a counterparty is organised does not extend to the netting of those off balance sheet exposures listed in the Solvency Ratio Directive: the amendment to this directive (to permit netting)specifically requires this matter to be addressed in the legal opinion.

13.

It is recognised that, with certain aspects of the agreement, it may not be possible to obtain a definite opinion or that a positive opinion regarding enforceability of the netting agreement can only be obtained subject to certain assumptions and/or qualifications. Where qualifications are made, they should be specific and their effect adequately explained. In the same way, assumptions should be specific, of a factual nature (except in relation to matters subject to the law of a jurisdiction other than that covered by the opinion)and should be explained in the opinion.

14.

Legal opinions on netting agreements must be obtained from independent legal advisers with sufficient expertise and experience in this area of law. Opinions from in-house counsel will not be acceptable. Where the regulator in the jurisdiction of the counterparty is satisfied that the netting agreement is not enforceable under the laws of that jurisdiction, the netting agreement cannot be relied upon regardless of the opinions obtained by a firm.

COMPLIANCE WITH THE LEGAL REQUIREMENTS

15.

It is the responsibility of firms to ensure that the legal requirements set out above are met (firms are to calculate CRR on the gross value of exposures to counterparties where this is not the case).Firms do not need to apply to the FCA in order to net exposures. Similarly, legal opinions on netting agreements and the agreements themselves are not required to be submitted to the FCA for approval. The FCA will establish the existence of legal opinions and netting agreements when compliance with the above requirements is being monitored by its staff.

16.

Firms are expected to put procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in light of possible changes in the relevant law.

17.

Firms are expected to maintain records demonstrating that, in relation to the legal requirements, the following considerations have been addressed:

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

18.

Firms are expected to hold a copy of the legal opinion and the agreement to which it relates.

19.

Firms are to net exposures within a particular rule on a FIFO basis. Firms may net only current exposures and cannot net potential future exposures.

CROSS-PRODUCT NETTING

Introduction

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

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

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

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

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