

**CHANGING ACCOUNTING FRAMEWORK (PRUDENTIAL CAPITAL)  
INSTRUMENT 2005**

**Powers exercised**

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

**Commencement**

- C. This instrument comes into force on 21 April 2005.

**Amendments to the handbook**

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

(1)	(2)
Glossary of definitions	Annex A
Integrated Prudential sourcebook (PRU)	Annex B
Interim Prudential sourcebook for Banks (IPRU(BANK))	Annex C
Interim Prudential sourcebook for Building Societies (IPRU(BSOC))	Annex D
Interim Prudential sourcebook for Friendly Societies (IPRU(FSOC))	Annex E
Interim Prudential sourcebook for Investment Businesses (IPRU(INV))	Annex F
Supervision manual (SUP)	Annex G

**Citation**

- E. This instrument may be cited as the Changing Accounting Framework (Prudential Capital) Instrument 2005.

By order of the Board  
21 April 2005

## Annex A

### Amendments to the Glossary

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

<u>deficit reduction amount</u>	<u>in respect of a <i>defined benefit occupational pension scheme</i>, the sum, determined by a <i>firm</i> in conjunction with the <i>defined benefit occupational pension scheme's</i> actuaries or trustees (or both), of the additional funding (net of tax) that will be required to be paid into that scheme by the <i>firm</i> over the following five year period for the purpose of reducing the <i>firm's defined benefit liability</i>.</u>
<u>defined benefit asset</u>	<u>the excess of the value of the assets in a <i>defined benefit occupational pension scheme</i> over the present value of the scheme liabilities, to the extent that a <i>firm</i>, as employer, in accordance with the accounting principles applicable to it, should recognise that excess as an asset in its balance sheet.</u>
<u>defined benefit liability</u>	<u>the shortfall of the value of the assets in a <i>defined benefit occupational pension scheme</i> below the present value of the scheme liabilities, to the extent that a <i>firm</i>, as employer, in accordance with the accounting principles applicable to it, should recognise that shortfall as a liability in its balance sheet.</u>
<u>defined benefit occupational pension scheme</u>	<u>an <i>occupational pension scheme</i> which is not a <i>defined contribution occupational pension scheme</i>.</u>
<u>defined benefits pension scheme</u>	(1) <del>(except in <i>PRU</i>) a pension policy or a pension contract</del> under which the only <i>money-purchase benefits</i> are benefits ancillary to other benefits which are not <i>money-purchase benefits</i> ;  (2) <del>(in <i>PRU</i>) an <i>occupational pension scheme</i> under which the only <i>money-purchase benefits</i> are benefits ancillary to other benefits which are not <i>money-purchase benefits</i>.</del>
<u>defined contribution occupational pension scheme</u>	<u>an <i>occupational pension scheme</i> into which a <i>firm</i>, as employer, pays regular fixed contributions and will have no legal or constructive obligation to pay further contributions if the scheme does not have sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.</u>
<u>parent undertaking</u>	(in accordance with section 420 of the <i>Act</i> (Parent and subsidiary undertaking) and section 258 of the Companies Act 1985 (Parent and subsidiary undertakings)):  (a) ...

(v) ~~it has a participating interest (as defined in section 260 of the Companies Act 1985) (Participating interests) in S;~~  
~~and~~

(A) it has the power to exercise, or actually exercises, a dominant influence or control over S; or

(B) it and S are managed on a unified basis; or ...

(vi) ...

...

## Annex B

### Amendments to the Integrated Prudential sourcebook

In this Annex, underlining indicates new text and striking through indicates deleted text. For the convenience of readers it is in three parts.

#### Part 1: amendments relating to insurers

##### 1.3 Valuation

...

General requirements: accounting principles to be applied

1.3.5 R Subject to PRU 1.3.5AR and PRU 1.3.5BR, ~~E~~except where a rule in PRU provides for a different method of recognition or valuation, whenever a rule in PRU refers to an asset, liability, equity or income statement item, a firm must, for the purpose of that rule, recognise the asset, liability, equity or income statement item and measure its value in accordance with:

- (1) the *insurance accounts rules*, or the Friendly Societies (Accounts and Related Provisions) Regulations 1994;
- (2) Financial Reporting Standards and Statements of Standard Accounting Practice issued or adopted by the Accounting Standards Board; and
- (3) Statements of Recommended Practice, issued by industry or sectoral bodies recognised for this purpose by the Accounting Standards Board;  
or
- (4) *international accounting standards*;

as applicable to the *firm* for the purpose of its external financial reporting (or as would be applicable if the *firm* was a company with its head office in the United Kingdom).

1.3.5A R For the purposes of PRU, except where a rule in PRU provides for a different method of recognition or valuation, when a firm, upon initial recognition, designates its liabilities as at fair value through profit or loss, it must adjust any value calculated in accordance with PRU 1.3.5R by subtracting any unrealised gains or adding back in any unrealised losses which are not attributable to changes in a benchmark interest rate.

1.3.5B R For the purposes of PRU, except where a rule in PRU provides for a different method of recognition or valuation, in respect of a defined benefit occupational pension scheme:

- (1) a firm must derecognise any defined benefit asset;

(2) a firm may substitute for a defined benefit liability the firm's deficit reduction amount.

1.3.5C R An election made under PRU 1.3.5BR(2) must be applied consistently for the purposes of PRU in respect of any one financial year.

1.3.5D R A firm should keep a record of and be ready to explain to its supervisory contacts in the FSA the reasons for any difference between the deficit reduction amount and any commitment the firm has made in any public document to provide funding in respect of a defined benefit occupational pension scheme.

1.3.6 G *PRU 1.3.5R provides that unless a rule in PRU provides for a different method of recognition or valuation, the applicable provisions of the Companies Act 1985, the Companies Act (Northern Ireland) Order 1986 or the Friendly Societies (Accounts and Related Provisions) Regulations 1994, as supplemented by Financial Reporting Standards, Statements of Standard Accounting Practice, and Statements of Recommended Accounting Practice, or, where applicable, international accounting standards, should be used to determine the recognition and valuation of assets, liabilities, equity and income statement items for the purposes of PRU, including:*

- (1) whether, and when, to recognise or de-recognise an asset or liability;
- (2) the amount at which to value an asset, liability, equity or income statement item;
- (3) which description to place on an asset, liability, equity or income statement item.

...

1.3.8G Where assets or liabilities are securitised, *PRU 1.3.5R only permits de-recognition where Financial Reporting Standard 5 (or, where applicable, International Accounting Standard 39) permits either de-recognition or the linked presentation. However, the FSA will consider granting a waiver to permit de-recognition in other circumstances provided that the firm can demonstrate that securitisation has effectively transferred risk.*

...

Valuation adjustments or reserves

...

1.3.30R If the result of establishing adjustments or reserves under *PRU 1.3.26R to PRU 1.3.29R* is a valuation which differs from the fair value determined in accordance with ~~*PRU 1.3.5R Financial Reporting Standards issued or adopted by the Accounting Standards Board*~~, a firm must reconcile the two valuations.

...

## 2.2 Capital resources

...

### Valuation differences

...

2.2.79G Additions to and deductions from *capital resources* will arise from the application of asset and liability valuation and admissibility rules (see PRU 1.3, PRU 2.2.86R and PRU 2 Ann 1R). Downward adjustments include *discounting of technical provisions for general insurance business* (which is optional for financial reporting but not permitted for regulatory valuation – see PRU 2.2.80R to PRU 2.2.81R) and derecognition of any defined benefit asset in respect of a defined benefit occupational pension scheme (see PRU 1.3.5BR). Details of valuation differences relating to *technical provisions* and liability adjustments for *long-term insurance business* are set out in PRU 7.3. In particular, contingent loans or other arrangements which are not valued as a liability under PRU 7.3.79R(2) result in a positive valuation difference.

2.2.80R PRU 2.2.81R applies to a *firm* that carries on *general insurance business*, except a *pure reinsurer*, and which *discounts* or reduces its *technical provisions for claims* outstanding, ~~to take account of its investment income as permitted by Article 60(1)g of the Annual Accounts Directive.~~

2.2.81R A *firm* of a kind referred to in PRU 2.2.80R must deduct from its *capital resources* the difference between the undiscounted *technical provisions* or *technical provisions* before deductions ~~as disclosed in the notes on the accounts,~~ and the discounted *technical provisions* or *technical provisions* after deductions. This adjustment must be made for all *general insurance business classes*, except for risks listed in *classes 1 and 2*. For *classes* other than 1 and 2, no adjustment needs to be made in respect of the discounting of annuities included in *technical provisions*. For *classes 1 and 2* (other than annuities), if the expected average interval between the settlement date of the *claims* being discounted and the accounting date is not at least four years, the *firm* must deduct:

- (1) the difference between the undiscounted *technical provisions* and the discounted *technical provisions*; or
- (2) where it can identify a subset of *claims* such that the expected average interval between the settlement date of the *claims* and the accounting date is at least four years, the difference between the undiscounted *technical provisions* and the discounted *technical provisions* for the other *claims*.

...

## 7.4 With-profits insurance capital component

...

### Realistic current liabilities

7.4.191 R ~~In~~ For the purpose of assessing the best estimate provision to be made under PRU 7.4.190R(1) in respect of a *defined benefits occupational pension scheme*, ~~the a~~ firm must use ~~the same amount as results from the application of PRU 1.3.5R~~ either its *defined benefit liability* or its *deficit reduction amount*, consistent with the firm's election under PRU 1.3.5BR(2).

**Part 2: amendments relating to insurance and mortgage intermediaries**

9.3 Capital resources for insurance and mortgage mediation activity and mortgage lending and administration:

Capital resources: ~~UK GAAP~~ relevant accounting principles

9.3.22 R A firm must recognise an asset or liability, and measure its amount, in accordance with the relevant ~~UK generally accepted~~ accounting principles applicable to it for the purpose of preparing its annual financial statements unless a *rule* requires otherwise.

...

The calculation of a firm's capital resources

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

	Item	Additional explanation
1.	...	...
2.	Capital other than <i>share capital</i> (for example, the capital of a <i>sole trader</i> , <i>partnership</i> or <i>limited liability partnership</i> )	<p>The capital of a <i>sole trader</i> is the net balance on the <i>firm's</i> capital account and current account.  The capital of a <i>partnership</i> is the capital made up of the <i>partners'</i>:</p> <p>(1) capital account, that is ...:  (a) ...  (b) ...:  (i) ...  (ii) ...</p> <p>(2) ...</p> <p><u>For the purpose of the calculation of capital resources, in respect of a <i>defined benefit occupational pension scheme</i>:</u></p> <p>(1) <u>a firm must derecognise any <i>defined benefit asset</i>;</u>  (2) <u>a firm may substitute for a <i>defined benefit liability</i> the <i>firm's deficit reduction amount</i>, provided that</u></p>

		<u>the election is applied consistently in respect of any one financial year.</u>
3.	Audited reserves	<p>These are the audited accumulated profits retained by the <i>firm</i> (after deduction of tax, dividends and proprietors' or <i>partners</i>' drawings) and other reserves created by appropriations of share premiums and similar realised appropriations. Reserves also include gifts of capital, for example, from a <i>parent undertaking</i>.</p> <p><u>For the purposes of calculating capital resources, a <i>firm</i> must make the following adjustments to its audited reserves, where appropriate:</u></p> <p>(1) <u>a <i>firm</i> must deduct any unrealised gains or, where applicable, add back in any unrealised losses on debt instruments held in the available-for-sale financial assets category;</u></p> <p>(2) <u>a <i>firm</i> must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;</u></p> <p>(3) <u>in respect of a <i>defined benefit occupational pension scheme</i>:</u></p> <p>(a) <u>a <i>firm</i> must derecognise any <i>defined benefit asset</i>;</u></p> <p>(b) <u>a <i>firm</i> may substitute for a <i>defined benefit liability</i> the <i>firm's deficit reduction amount</i>, provided that the election is applied consistently in respect of any one financial year.</u></p>
4.	...	
5.	...	
6.	<u>General/collective provisions</u>	<p>These are provisions that a <i>firm</i> carrying on <i>mortgage lending</i> or <i>mortgage administration</i> holds against potential losses that have not yet been identified but which experience indicates are present in the <i>firm's</i> portfolio of assets. Such provisions must be freely available to meet these unidentified losses wherever they arise.</p> <p>General/collective provisions must be verified by external auditors and disclosed in the <i>firm's</i> annual report and accounts.</p>
7.	...	



9.3.52A G A firm should keep a record of and be ready to explain to its supervisory contacts in the FSA the reasons for any difference between the deficit reduction amount and any commitment the firm has made in any public document to provide funding in respect of a defined benefit occupational pension scheme.

...

### Part 3 : amendments to transitional provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
12	PRU 1.3.5R PRU 7.4.191R	R	<p><del>[deleted](1) This rule applies to a firm which for the period specified in column (5) is required by PRU 1.3.5R to measure the surplus or deficit in a defined benefits pension scheme, for the purposes of PRU, in accordance with FRS 17 (Retirement Benefits).</del></p> <p><del>(2) A firm must derecognise any measure of actuarial gains in respect of a defined benefits pension scheme.</del></p> <p><del>(3) A firm may deduct from its liabilities the difference between the measure of actuarial losses in respect of a defined benefits pension scheme which would result from the application of PRU 1.3.5R and the firm's best estimate of the level of additional funding that it will provide for that defined benefits pension scheme over the next five years, as determined in conjunction with the scheme's actuaries or trustees (or both) as appropriate.</del></p>	From 31 December 2004 to 30 December 2005	31 December 2004

## Annex C

### Amendments to the Interim Prudential sourcebook for Banks

In this Annex, underlining indicates new text and striking through indicates deleted text. For the convenience of readers it is in two parts.

#### Part 1: amendments to Volume 1 of the Interim Prudential sourcebook for Banks

##### Chapter CO CAPITAL ADEQUACY OVERVIEW

...

##### 5 APPENDIX: OPTIMISING THE USE OF CAPITAL IN CAPITAL ADEQUACY CALCULATIONS

...

3 Optimisation of the use of capital may be achieved by carrying out the calculations in the following order (although in which steps (b), (c) and (d) are carried out is not critical):

...

(f) Identify general/collective provisions in excess of 1.25% of the sum of risk weighted assets in the banking book and notional risk weighted assets in the trading book; these should not be included in Tier 2 capital.

...

##### Chapter CA DEFINITION OF CAPITAL

##### 1 INTRODUCTION

1.1 How this chapter is organised

...

2 The rest of this section ...

....Section 13 is an appendix giving ~~a~~ proformas for an auditor's opinion on interim profits.

...

##### 2 THE NATURE OF CAPITAL

...

2.3 Types of capital

...

8 Like Tier 1, Upper Tier 2 can be split between issued and internally generated capital.

(a) ...

(b) Internally generated Upper Tier 2 capital includes general/collective provisions and certain revaluation reserves.

...

### 3 INITIAL AND ON-GOING MINIMUM CAPITAL REQUIREMENTS

#### 3.1 Minimum Capital Requirement

...

2 ...

a) Capital that can be used for the minimum initial capital requirement is:

- Fully paid-up ~~shareholders' equity~~ share capital, plus share premium accounts, but excluding cumulative preferential shares;

...

### 4 ELEMENTS OF A BANK'S CAPITAL BASE

...

#### 4.2 Tier 1 - core capital

...

1 Tier 1 (or core) capital consists of:

...

(c) Retained profit and loss arising during the course of the current year where verified by a bank's external auditors.

a) This should be net of tax, ~~anticipated~~ declared dividends and other appropriations.

...

2 In calculating a bank's capital base, a number of deductions should be made from Tier 1:

...

(d) Fully paid ~~shareholders' equity~~ up share capital issued after 1 January 1992 by the capitalisation of property revaluation reserves.

#### 4.3 Tier 2 - supplementary capital

3 Tier 2 (or supplementary) capital consists of:

(a) Reserves arising from the revaluation of tangible fixed assets and fixed asset investments, including any net unrealised gains for the fair valuation of equities held in the available-for-sale financial assets category.

(b) Fully paid ~~shareholders' equity~~ up share capital issued after 1 January 1992 by the capitalisation of property reserves.

(c) General/collective provisions.

...

5 TIER 1 CAPITAL

...

5.2 Reserves

6 *Reserves* are accumulated profits retained by the bank after the payment of all dividends and tax, and other reserves created by appropriations of share premia and other surpluses.

a) Dividends should be deducted from reserves as soon as they are declared.

(a) For the purposes of calculating prudential capital a bank should:

(i) deduct unrealised gains or, where applicable, add back in unrealised losses, on cash flow hedges of financial instruments measured at cost or amortised cost;

(ii) deduct unrealised gains or, where applicable, add back in unrealised losses, on debt instruments held in the available-for-sale financial assets category;

(iii) deduct unrealised gains or, where applicable, add back in unrealised losses, which are not attributable to changes in a benchmark interest rate, arising when a bank, upon initial recognition, designates its financial liabilities as at fair value through profit or loss;

(b) A defined benefit asset should not be considered part of reserves.

a) a defined benefit asset is the excess of the value of the assets in a defined benefit occupational pension scheme over the present value of the scheme liabilities, to the extent that a bank, as employer, in accordance with the accounting principles applicable to it, should recognise that excess as an asset in its balance sheet;

b) a defined benefit occupational pension scheme is an occupational pension scheme which is not a defined contribution occupational pension scheme;

c) a defined contribution occupational pension scheme is an occupational pension scheme into which a bank, as employer, pays regular fixed contributions and will have no legal or constructive obligation to pay further contributions if the scheme does not have sufficient assets to pay all employee

benefits relating to employee service in the current and prior periods.

(c) A bank may, for the purposes of calculating prudential capital, substitute for a defined benefit liability its deficit reduction amount. The election should be applied consistently in respect of any one financial year. A bank should keep a record of and be ready to explain to its supervisory contacts in the FSA the reasons for any difference between the deficit reduction amount and any commitment the bank has made in any public document to provide funding in respect of a defined benefit occupational pension scheme.

a) a defined benefit liability is the shortfall of the value of the assets in a defined benefit occupational pension scheme below the present value of the scheme liabilities, to the extent that a bank, as employer, in accordance with the accounting principles applicable to it, should recognise that shortfall as a liability in its balance sheet.

b) the bank's deficit reduction amount is, in respect of a defined benefit occupational pension scheme, the sum, determined by the bank in conjunction with the defined benefit occupational pension scheme's actuaries or trustees (or both), of the additional funding (net of tax) that will be required to be paid into that scheme by the bank over the following five year period for the purpose of reducing the bank's defined benefit liability.

5.3 Retained profit and loss

7 Current year interim profits, net of any tax, ~~anticipated~~ declared dividends and other appropriations, may be included in Tier 1 capital where they have been verified by the bank's external auditors.

...

10 The auditors should submit an opinion to the bank on whether the interim profits are fairly stated. This should be submitted to the FSA. Banks that report electronically should submit a hard copy of the auditors' report to the FSA.

a) ~~A Proforma~~ for an auditor's opinion is on the verification of interim profits is are included in the Appendix. Proforma 1 is for banks where the external auditor is submitting an opinion on the interim profits in the year in which the bank is publishing its first financial statements under international accounting standards (see definition in the main Glossary). Proforma 2 is for all other years.

6 UPPER TIER 2 CAPITAL

...

- 6.1 Reserves arising from the revaluation of tangible fixed assets and fixed asset investments
- 1 ...
- b) Where ~~n~~Negative goodwill is required to be identified under the adopted accounting framework it will be also included in reserves. *Negative goodwill* arises when a company/ portfolio is purchased below the value of its assets. The difference is called negative goodwill.
- ...
- 6.2 General/collective provisions
- 2 *General/collective provisions* - funds that the company holds in reserve against losses which have not yet been individually identified – should be included in Tier 2 capital up to a maximum of 1.25% of the sum of *risk weighted assets*.
- ...
- c) *Specific/individual provisions* - funds held in reserve against individually identified losses – are not included in capital.
- ...
- 6.4 Fully paid ~~shareholders' equity~~ up share capital issued after 1 January 1992 by the capitalisation of property revaluation reserves
- 4 Equity Shares issued by the capitalisation of property revaluation reserves, if issued before 1 January 1992, may be included in Tier 1. All ~~such equity shares~~ equity shares issued after that date should be included in Upper Tier 2.
- ...
- b) Prior to 1992 a number of banks issued fully paid bonus shares through the capitalisation of property revaluation reserves. The inclusion of such equity shares in Tier 1 capital was not permitted by any other signatory of the Basel Agreement and has been prohibited in the United Kingdom since 1992.
- ...
- 6.5 Hybrid capital instruments
- ...
- 6 Upper Tier 2 capital instruments therefore include:
- ...
- (b) Perpetual subordinated debt, including such debt which is convertible into equity shares. The converted debt should not be included within Tier 1 capital until the conversion has taken effect.
- ...
- 6.7 Convertible loan stock
- 8 ...

- (d) any perpetuals exchanged for equity shares should be cancelled, and not held by the issuing bank for possible future re-issue.

8 GENERAL CONDITIONS FOR SUBORDINATED DEBT

...

8.5 Issuing debt

8.5.1 Procedures for issuing subordinated loan capital

...

17 For Upper Tier 2 subordinated debt the debt agreement should contain an explicit warning to lenders of the condition for the automatic or deemed conversion of the debt into equity shares in the event of the liquidation of the bank, or of any provisions for the debt to be treated as if it had been converted into equity shares immediately preceding the winding-up of a bank, i.e. a deemed conversion.

...

10 DEDUCTIONS FROM CAPITAL

10.1 Deductions from Tier 1 capital

1 The following items should be deducted from Tier 1 capital:

...

- (d) Fully paid ~~shareholders' equity~~ up share capital issued after 1 January 1992 arising from the capitalisation of *property revaluation reserves*.

a) *Property revaluation reserves* are eligible for inclusion in upper Tier 2 capital.

...

ii) ~~Equity Shares~~ issued in this manner prior to January 1992 does not need to be deducted from Tier 1 capital.

- (e) Net unrealised losses on equities held in the available-for-sale financial assets category.

10.2 Deductions from the total of Tier 1 and Tier 2 capital

2 Certain deductions should be made from the total of Tier 1 (after Tier 1 deductions) and Tier 2 capital:

...

- (c) All holdings of capital instruments issued by other *credit institutions* and *financial firms* unless these are covered by a *trading book concession*;

a) This deduction applies to:

...

- ~~Equity holdings~~ Investments in investment trusts, ~~and holdings of units in~~ unit trusts, mutual funds or other investment vehicles established exclusively or mainly to hold *credit* or *financial institutions'* capital instruments;

...

10.3 Exemptions from the deduction policy

...

10.3.1 Trading book “*concessions*”

...

7 ... A bank should also deduct the excess of any direct or indirect holdings which exceed an amount equal to 10% of the paid up ~~equity~~ share capital of the credit or financial institution in which the holding is made.

...

11 APPLICATION AND LIMITS OF CAPITAL

...

11.3 Limits on capital for non-CAD banks

6 The limits non-CAD banks should apply are that:

...

(c) General/collective provisions should not be more than 1.25% of risk weighted assets.

a) This determines the maximum level of general/collective provisions that a bank should include in its capital base. Clearly, a bank can make more general/collective provisions if it chooses.

11.4 Limits on capital for CAD banks

7 CAD banks should apply the following limits:

...

(b) General/collective provisions should not exceed 1.25% of the sum of risk weighted assets in the banking book and notional risk weighted assets in the trading book.

13 APPENDIX – PROFORMA 1 - FOR EXTERNAL AUDITOR'S REPORT ON INTERIM PROFITS IN YEAR OF TRANSITION TO ANOTHER ACCOUNTING FRAMEWORK (eg FROM UK GAAP TO IFRS)

THE BOARD OF DIRECTORS, XYZ BANK LIMITED

Dear Sirs

In accordance with your letter of instruction dated [ ], a copy of which is attached, we have reviewed XYZ Bank Ltd's current year interim profits for the period [ ] as reported on Form BSD3 [or successor form] dated [ ] a copy of which is attached for identification. Our review, which did not constitute an audit, has been carried out having regard to the conditions set out in Section 5 of the chapter on the “Definition of Capital” in the Prudential Sourcebook applying to banks.



On the basis of the results of our review, nothing came to our attention to indicate that :

- (a) the interim profits as reported on Form BSD3 have not been calculated on the basis of accounting policies adopted by the bank to report under international accounting standards for the year to [ ]. These accounting policies are not necessarily consistent with those used in preparing the bank's latest statutory accounts for the year to [ ].'
- (b) the accounting policies adopted by the bank to report under international accounting standards differ in any material respects from those required by the international accounting standards adopted from time to time by the European Commission in accordance with EC Regulation No 1606/2002, [except for...];
- (c) the interim profits amounting to £[ ] as so reported are not reasonably stated.

Yours faithfully  
Chartered Accountants

PROFORMA 2 – FOR EXTERNAL AUDITOR'S REPORT ON INTERIM PROFITS (WHERE THERE IS NO CHANGE IN ACCOUNTING FRAMEWORK)

THE BOARD OF DIRECTORS, XYZ BANK LIMITED

Dear Sirs

- (a) the interim profits as reported on Form BSD3 have not been calculated on the basis of accounting policies adopted by the bank to report under international accounting standards for the year to [ ] [except for ...];
- (b) those accounting policies differ in any material respects from those required by [the Banks Accounts Directive as implemented in the UK *or, where relevant, the international accounting standards adopted from time to time by the European Commission in accordance with EC Regulation No 1606/2002*], [except for];

...

Chapter BC CREDIT RISK IN THE BANKING BOOK

3 RISK WEIGHTING FRAMEWORK: ON BALANCE SHEET

...

3.2 Counterparty Weights

...

3.2.5 50% weighting:

7 The following types of asset should attract a 50% weighting:

...

(a) ...

“Fully secured” means the value of property should be greater than or equal to the value of the loan (ie maximum loan to value of 100%). There is no requirement to revalue properties on a regular basis, but where such a valuation has found that the loan to value ratio exceeds 100% such loans should be weighted at 100%. (However, if the shortfall in the security value is fully covered by a specific or individual provision, the net amount of the exposure may continue to be weighted at 50%.) Conversely, where revaluation indicates that the loan to value ratio has fallen to 100% the loan may be weighted at 50%.

(b) ...

## Part 2: amendments to Volume 2 of the Interim Prudential sourcebook for Banks

### Chapter LE LARGE EXPOSURES

...

4 KEY DEFINITIONS: LARGE EXPOSURES CAPITAL BASE, LARGE EXPOSURES AND EXPOSURES

...

4.4 Reducing an exposure

...

4.4.4 Bad debt provisions

11 An exposure reported at book value should be gross of specific/individual provisions for bad and doubtful debts. Similarly, where an exposure is marked to market the valuation is typically gross of any provisions. However, for monitoring against limits, a specific/individual provision made against a loan should be set off against the gross amount of the exposure.

a) ...

5 KEY DEFINITIONS: COUNTERPARTY

...

5.3 Connected counterparties

...

9 *Parties connected to a bank* comprise:

(a) ~~‘group undertakings’ (including subsidiaries) as defined by section 259 of the Companies Act 1985 as amended by the Companies Act 1989~~ ‘parent undertakings’, ‘subsidiary undertakings’ and ‘related companies’.

‘Parent undertakings’ and ‘subsidiary undertakings’ have, for the purposes of consolidated supervision and large exposures, the meanings given in Articles 1(12) and (13) of the BCD, by reference to the Seventh Company Law

Directive 83/349/EEC. Those provisions are implemented in s258 of the Companies Act 1985.

A 'related company', ...

...

## Chapter SE SECURITISATION AND ASSET TRANSFERS

### 6 BASIS OF THE POLICY: LIMITING THE ASSOCIATION WITH THE ASSETS

...

#### 6.3 Additional policy relating to asset packages

...

#### 6 ...

- (b) The FSA expects the performer of the primary role to have evidence available in its records that ~~its auditors are satisfied that~~ the terms of the scheme satisfy the conditions for non-consolidation of an SPE, derecognition or linked presentation set out in ~~comply with~~ FRS5.

...

## Chapter VA VALUATION

### 2 GENERAL POLICY ON VALUATION

...

#### 6 ~~[deleted]The Companies Act requires a bank to value the majority of its assets and liabilities in accordance with the *historical cost* rules.~~

#### 7 ~~[deleted]The *historical cost* rules require:~~

- ~~(a) a *fixed asset* to be valued at original cost on acquisition less any provisions for depreciation or diminution in value; and~~
- ~~a) — A *fixed asset* is an asset that a bank purchases for retention and continuing use in its business.~~
- ~~b) — There are three main types of *fixed assets*:~~
- ~~i) — ‘intangible assets’, such as patents and goodwill;~~
- ~~ii) — ‘tangible assets’, such as land, premises, machinery and equipment; and.~~
- ~~iii) — ‘fixed asset investments’, ie shares and loans to other companies.~~
- ~~(b) a *current asset* to be valued at the lower of cost and net realisable value.~~

- a) ~~A *current asset* is an asset which is not a fixed asset; generally, a *current asset* should be readily convertible into cash.~~

8 ~~[deleted]The historical cost rules do, however, allow transferable securities held for trading purposes to be valued at market value.~~

9 ~~[deleted]Some assets may be valued according to alternative accounting rules. One practical effect is that certain fixed assets, notably land and premises, can be revalued to current market value, with any revaluation surplus (loss) taken to (from) a revaluation reserve.~~

...

## Chapter NE COLLATERAL AND NETTING

### 7 ON BALANCE SHEET NETTING

#### 7.1 Overview

1 ...

2 ...

- a) In reporting on a net basis, banks should have regard to accounting guidelines where relevant. ~~Reporting of net balances should follow the bank's statutory accounting practices.~~
- b) ...

## Chapter CS CONSOLIDATED SUPERVISION

### 4.3 Companies to be consolidated

3 ...

- a) The definitions used of *parent* and *subsidiary* are those contained in for the purposes of consolidated supervision derive from Articles 1(12) and (13) of the BCD. These provisions refer to Article 1(1) of the Seventh Company Law Directive (83/349/EEC); these are implemented in the United Kingdom in section 258 of the Companies Act 1985. The definition of *participation* is set out in the Table in chapter GN.

...

## Chapter PN PROVISIONING POLICY STATEMENTS

### 1 INTRODUCTION

- 1.1 Context
- 1 This chapter deals explicitly with provisioning policy statements and provisions in their generality, although general/collective provisions are mentioned in the context of the definition of capital.
- ...
- 2 THE FSA'S BASIC APPROACH TO PROVISIONING
- ...
- 2 The FSA's overall approach is that a bank should hold an adequate level of provisions. The FSA accepts that what is 'adequate' will differ between banks, according to the precise nature and scale of the business(es) they undertake. These provisions may be in the form of general/collective or specific/individual provisions.
- ...
- 3 THE PROVISIONING POLICY STATEMENT
- ...
- 3.2 Issues relating to provisioning for credit exposures and other liabilities
- ...
- 6 How often are the provisions reviewed? By whom? What is the system of review?
- As the status of the exposures/potential losses changes, so the level of provisions held against them will need to be adjusted. The policy documentation should provide for regular reviews of provisions (both general/collective and specific/individual) to cater for sudden changes in conditions associated with the exposures.
- ...
- 3.3 Issues relating to provisioning for credit exposures only
- ...
- 12 How are specific/individual provisions calculated? Is it the result of a formula, a loan grading policy or another method?
- How the level of specific/individual provisions is calculated is important both for consistency and to ensure that there is an audit trail showing the methodology used.
- 13 Who decides whether the proposed level of specific/individual provisions on an individual non-performing exposure is adequate?
- ...
- 14 What methodology determines the level of general/collective provisions on credit exposures?

Does the bank make general/collective provisions according to a formula or is it left to management or a committee to decide? Does the formula provide a methodology to determine latent impairment in the portfolio?

## Annex D

### Amendments to the Interim Prudential sourcebook for Building Societies

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

#### Vol 1 Chapter 1 Solvency

##### 1.6 Own Funds

...

1.6.4 G Whenever a calculation of own funds is to be made other than at the balance sheet date, the amount of reserves included should be after deduction of any overall losses in the current year:

- (1) ...
- (2) ...

Where a society includes general or collective provisions in its solvency ratio calculation other than at balance sheet date then as a minimum it should have passed a board resolution, after the close of the second financial quarter, to the effect that the directors have satisfied themselves that ~~the general~~ those provisions meet the requirements set out in Annex 1A3.1.

...

##### 1.8 Deductions

...

1.8.2 G ...

1.8.3 G Societies may not include the following in own funds:

- (1) any unrealised gains or losses on cash flow hedges of financial instruments measured at cost or amortised cost;
- (2) any unrealised gains or losses on debt instruments held in the available-for-sale financial assets category;
- (3) any unrealised gains or losses, which are not attributable to changes in a benchmark interest rate, arising when a building society, upon initial recognition, designates its financial liabilities as at fair value through profit or loss;
- (4) any defined benefit asset.

1.8.4 G Societies may, for the purpose of calculating own funds, substitute for a defined benefit liability their deficit reduction amount. The election should be applied consistently in respect of any one financial year. Societies should keep a record of and be ready to explain to their supervisory contacts in the FSA the reasons for any difference

between the deficit reduction amount and any commitment a society has made in any public document to provide funding in respect of a defined benefit occupational pension scheme. For these purposes, and for the purpose of 1.8.3G:

- (1) a "defined benefit occupational pension scheme" is an occupational pension scheme which is not a defined contribution occupational pension scheme.
- (2) a "defined contribution occupational pension scheme" is an occupational pension scheme into which the society, as employer, pays regular fixed contributions and will have no legal or constructive obligation to pay further contributions if the scheme does not have sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.
- (3) "occupational pension scheme" is defined in the main glossary of defined terms in the Handbook, and is derived from the Pension Schemes Act 1993.
- (4) a "defined benefit asset" is the excess of the value of the assets in a defined benefit occupational pension scheme over the present value of the scheme liabilities, to the extent that a society, as employer, should recognise that excess as a liability in its balance sheet.
- (5) a "defined benefit liability" is the shortfall of the value of the assets in a defined benefit occupational pension scheme below the present value of the scheme liabilities, to the extent that a society, as employer, should recognise that shortfall as a liability in its balance sheet.
- (6) a society's "deficit reduction amount" is, in respect of a defined benefit occupational pension scheme, the sum, determined by the society in conjunction with the defined benefit occupational pension scheme's actuaries or trustees (or both), of the additional funding (net of tax) that will be required to be paid into that scheme by the society over the following five year period for the purpose of reducing the society's defined benefit liability.

...

## 1.10 Solvency Ratio

1.10.1 G ... Asset values and values attributed to off balance sheet items should also be determined on a basis consistent with the statutory Accounts Regulations and should be net of any specific/individual provisions. Where a society has subsidiary undertakings, the solvency ratio should be calculated on a consolidated basis. For these purposes a subsidiary undertaking is defined by Article 1(13) of the BCD, which refers to Article 1(1) of the Seventh Company Law Directive (83/349/EEC); these provisions are implemented in section 258 of the Companies Act 1985, to which section 119(1) of the 1986 Act refers. ~~Consolidation should be on the same basis as applies to the society's statutory accounts (i.e.~~



~~the Accounts Regulations~~). Where subsidiary undertakings, either singly or in aggregate, have either:

...

Annex 1A

Calculation of "Own Funds"

Ann1A G

1A.1 Tier 1 Capital

...

1A.1.4 ...

1A.1.5 Societies may not include the following in own funds:

- (1) any unrealised gains or losses on cash flow hedges of financial instruments measured at cost or amortised cost;
- (2) any unrealised gains or losses on debt instruments held in the available-for-sale financial assets category ;
- (3) any unrealised gains or losses, which are not attributable to changes in a benchmark interest rate, arising when a building society, upon initial recognition, designates its financial liabilities as at fair value through profit or loss;

1A.1.6 Where a society has a defined benefit occupational pension scheme:

- (1) it may not include any defined benefit asset in own funds;
- (2) it may, for the purpose of calculating own funds, substitute for a defined benefit liability its deficit reduction amount, provided that the election is applied consistently in respect of any one financial year.

Definitions of the terms used here are set out in 1.8.4G.

1A.2 Tier 2 Capital

1A.2.1 Term subordinated debt and undated subordinated debt, which meet the requirements of chapter 2; together with general or collective provisions for bad debt and revaluation reserves.

...

1A.3 General/Collective Provisions for Bad Debt

1A.3.1 General or collective provisions should be made to cover possible losses, existing at the balance sheet or other reporting date, which have not been specifically identified.

As such, they are freely available to the society to be utilised against any actual losses subsequently identified or arising and so conform with Article 35.1(a) of the BCD. But the BCD does not permit the inclusion in "own funds" of a provision which covers identified deterioration in particular assets, whether individual or group. Thus societies should not include the latter type of provision in own funds. Societies may only include general or collective provisions in their solvency ratio calculation to an amount less than or equal to that shown in the society's last audited accounts or the amount provided when interim profits were last verified by the external auditors.

...

#### 1A.6 Own Funds

...

1A.6.2 Article 34.2(3) of the BCD allows "funds for general banking risks" to be counted as Tier 1 capital. Such funds are not general or collective provisions for bad debt but are akin to banks' "hidden reserves" and are therefore not applicable to building societies.

#### Annex 1B

##### Risk Asset Weights

##### Ann1B G

##### 1B.1 General

1B.1.1 Risk weights should be applied net of any specific or individual provision. Items subject to deduction from Own Funds should be zero weighted. Assets held by a subsidiary undertaking are weighted on the same basis as if held by the parent society.

...

#### Annex 1E

##### Interim Profits: Verification Procedures

##### Ann1E G

##### 1E.1 Verification of Interim Profits by External Auditors

1E.1.1 The FSA interprets "verified" to mean obtaining a reasonable degree of comfort on the accuracy of the reported interim results. For this purpose, the analytical review procedures commonly used by auditors in the normal course of their work can be helpful and a combination of some of them will provide adequate assurance that reported interim profits are of sufficient quality for inclusion in the capital base, provided that the society has complied in all material respects with the relevant accounting valuation principles ~~of the Accounts Regulations~~.

...

1E.1.3 Verification by auditors should in normal circumstances entail at least the following:

- (1) ...
  - (2) reviewing the accounting policies used in calculating the interim profits so as to obtain comfort that they are consistent with those normally adopted by the society in drawing up its annual financial statements and are in accordance with the ~~principles set out in the Accounts Regulations~~ relevant accounting principles;
- ...

1E.1.4 The external auditors should submit an opinion to the society on whether the interim results are fairly stated. Proformas for the text of the reports are set out below. Proforma 1 is for building societies where the external auditor is submitting an opinion on the interim profits in the year in which the building society is publishing its first financial statements under international accounting standards. Proforma 2 is for all other years. The text of the report is set out below:

Proforma 1:

"Dear Sirs ...

In accordance with your letter of instruction dated [ ] we have reviewed [name of society's] current year interim profits for the period [ ] as reported on Form QFS1, a copy of which is attached for identification. Our review, which did not constitute an audit, has been carried out having regard to the FSA's Interim Prudential Sourcebook for building societies Chapter 1.

On the basis of the results of that review, nothing came to our attention to indicate that:

- (1) the interim profits as reported on QFS1 have not been calculated on the basis of the accounting policies adopted by the society to report under international accounting standards for the year to [ ]. These accounting policies are not necessarily consistent with those used in preparing the society's latest statutory accounts for the year to [ ];
- (2) the accounting policies adopted by the society to report under international accounting standards differ in any material respects from those required by the international accounting standards adopted from time to time by the European Commission in accordance with EC Regulation No. 1606/2002 [except for .....];
- (3) the interim profits amounting to £[ ] as so reported are not fairly stated."

Proforma 2:

"Dear Sirs ...

...

- (1) ...for the year to [ ], [except for];
- (2) those accounting policies differ in any material respects from those required by the Accounts Regulations [or, where relevant, the international accounting standards adopted from time to time by the European Commission in accordance with EC Regulation No. 1606/2002] [except for .....];
- (3) ..."

## Vol 1 Chapter 5 Liquidity

### 5.3 The Prudential Regime for Liquidity

...

5.3.4 G Liquid assets should be genuinely liquid i.e. they should be capable of being realised at very short notice. Only instruments or assets that are marketable (i.e. realisable in a secondary market) or have three months or less to run to maturity should (subject to the guidance in Annex 5A and in paragraph 5.5.2) be included in the calculation of liquidity for prudential purposes. Societies may hold other assets, but as an investment rather than liquidity (~~although such assets might still fall within the "liquid assets" heading in the annual accounts, which has no restriction on maturity~~). ~~The treatment in the annual accounts determines whether an asset is a liquid asset for the purposes of calculating the society's position in relation to the statutory limit in section 6 of the 1986 Act (the "lending limit").~~

## Annex 5C

### Inter-society Holdings

...

5C.2 G A society's aggregate holding of other societies' liabilities should not exceed 5% SDL or £5m whichever is the higher, ~~including liquid assets which, although not counting as prudential liquidity (i.e., deposits with longer than 3 months to run to maturity) are held as other investments and fall within the "liquid assets" heading in the annual accounts~~. The total should also include undrawn as well as drawn amounts under committed facilities provided to other societies. This measure is to be continuous.

...

## Volume 1 Chapter 6 Lending

...

### 6.2 Rules

...

6.2.2 R A society must maintain, and submit to the FSA, a board-approved policy statement on lending, which must include plans for the management of arrears, and the procedures for making specific and general (or individual and collective) provisions against impaired loans.

...

## 6.5 Risk Features of Mortgage Lending

...

### Managing Aggregate Lending Risk

6.5.5 G Societies should be aware of the risk profile of their overall mortgage stock and of their new lending and should consider lessons arising from experience with their nonperforming loans and adjust lending policy accordingly. These lessons should also inform general or collective provisioning policies.

...

## Volume 1 Chapter 9 Systems

### 9.3 Accounting Records and Systems

9.3.2 G Every building society is also required, under section 71(1) and (2) of the 1986 Act, to keep accounting records which:-

- (1) ...
- (2) ...
- (3) enable the directors properly to discharge the duties imposed on them by or under the 1986 Act (and where applicable Article 4 of EC Regulation No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards) and their functions of direction of the affairs of the society;
- (4) enable the society properly to discharge the duties imposed on it by or under the 1986 Act (and where applicable Article 4 of EC Regulation No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards).

...

## Volume 1 Chapter 10 Securitisation

SE6 Basis of the Policy: Limiting the Association with the Assets

...

### 6.3 Additional policy relating to asset packages

...

6 ...

(a) ...

(b) The FSA expects the performer of the primary role to have evidence available in its records that ~~its auditors are satisfied that~~ the terms of the scheme satisfy the conditions for non-consolidation of an SPE, derecognition or linked presentation set out in ~~comply with~~ FRS5.

...

## Annex E

### Amendments to the Interim Prudential sourcebook for Friendly Societies

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

#### Appendix 4 Asset valuation rules

#### Appendix 4

#### ASSET VALUATION RULES

...

#### Application

2. (1) ...

...

(6) Notwithstanding (1) (but subject to the conditions set out in (7) and subject to (10)) ...

...

(10) a friendly society must derecognise any defined benefit asset.

...

#### Appendix 5 Liability valuation rules

#### LIABILITY VALUATION RULES

...

#### Long-term and general insurance business

2. (1) ...

(2) ...

(3) A friendly society may substitute for a defined benefit liability its deficit reduction amount.

## Annex F

### Amendments to the Interim Prudential sourcebook for Investment Businesses

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

#### Chapter 3

#### 3 Chapter 3: FINANCIAL RESOURCES FOR SECURITIES AND FUTURES FIRMS WHICH ARE NOT INVESTMENT FIRMS

...

#### 3-62 Tangible net worth

...

#### Approved reserves

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

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

#### Profit and loss account/partners' current and capital accounts

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

(a) deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;

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

3-62(6) R A *firm* may, for the purposes of calculating *tangible net worth*, substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year.

3-62(7) G A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FSA* the reasons for any difference between the *deficit reduction amount* and any commitment the *firm* has made in any public document to provide funding in respect of a *defined benefit occupational pension scheme*.

...



Chapter 5

5 CHAPTER 5: FINANCIAL RESOURCES

...  
5.2.2 FINANCIAL RESOURCES

OWN FUNDS

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

...

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

PART 1  
METHOD OF CALCULATION

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

Financial resources	Category	Part II Para
Tier 1		
(1) Paid-up share capital (excluding preference shares)	A	2
(2) Share premium account		
(3) Audited reserves		<u>2A</u>
...		

PART II  
DETAILED REQUIREMENTS

...

2	Non corporate entities	(a) ...
		(b) ...
		(c) <u>For the calculation of <i>own funds</i>, partners' current accounts figures are subject to the following adjustments in respect of a <i>defined benefit occupational pension scheme</i>:</u>
		(i) <u>a <i>firm</i> must derecognise any <i>defined benefit asset</i>;</u>

- (ii) a firm may substitute for a defined benefit liability the firm's deficit reduction amount. The election must be applied consistently in respect of any one financial year.

Note

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

2A Audited reserves

For the calculation of own funds the following adjustments apply to the audited reserves figure:

- (a) a firm must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
- (b) in respect of a defined benefit occupational pension scheme, a firm must derecognise any defined benefit asset;
- (c) a firm may substitute for a defined benefit liability the firm's deficit reduction amount. The election must be applied consistently in respect of any one financial year.

Note

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

...

Chapter 7

7 UCITS MANAGEMENT COMPANIES

...

7.3 METHOD OF CALCULATION OF FINANCIAL RESOURCES

7.3.1 R This table belongs to *rule 7.2.1R (1)*

PART I		
A <i>firm</i> must calculate its financial resources as shown below, subject to the detailed requirements set out in Part II.		
Financial resources Para	Category	Part II
TIER 1		
(1) Paid-up share capital (excluding preference shares)	}	2
(2) Share premium account		A
(3) Audited reserves		<u>2A</u>
(4) Non-cumulative preference shares		
...		

PART II DETAILED REQUIREMENTS	
...	
2 Non corporate entities	
(a) ...	
(b) ...	
(c) <u>For the calculation of financial resources, partners' current accounts figures are subject to the following adjustments in respect of a <i>defined benefit occupational pension scheme</i>:</u>	
(i) <u>a <i>firm</i> must derecognise any <i>defined benefit asset</i>;</u>	
(ii) <u>a <i>firm</i> may substitute for a <i>defined benefit liability</i> the <i>firm's deficit reduction amount</i>. The election must be applied consistently in respect of any one financial year.</u>	
<u>Note</u>	
<u>A <i>firm</i> should keep a record of and be ready to explain to its supervisory contacts in the FSA the reasons for any difference between the <i>deficit reduction amount</i> and any commitment the <i>firm</i> has made in any public document to provide funding in respect of a <i>defined benefit occupational pension scheme</i>.</u>	

## 2A Audited reserves

For the calculation of financial resources, the following adjustments apply to the audited reserves figure:

- (a) a firm must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
- (b) in respect of a defined benefit occupational pension scheme, a firm must derecognise any defined benefit asset;
- (c) a firm may substitute for a defined benefit liability the firm's deficit reduction amount. The election must be applied consistently in respect of any one financial year.

### Note

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

...

## Chapter 10

10 Chapter 10: Financial resources for Securities and Futures  
Firms which are Investment Firms

...

10-61 INITIAL CAPITAL

...

Non cumulative preference share capital

10-61(3) R ...

Audited retained earnings

10-61(3A) R When calculating initial capital, a firm may include its audited retained earnings only after making the following adjustments:

- (a) a firm must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;

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

Externally verified interim net profits or current account

10-61(4) R ...

10-61(4A) R When calculating *initial capital*, a *firm* may include its partners' current accounts figure only after making the following adjustments:

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

Defined benefit pension scheme: defined benefit liability

10-61(4B) R For the calculation of *original own funds*, a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year.

10-61 (4C) G A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FSA* the reasons for any difference between the *deficit reduction amount* and any commitment the *firm* has made in any public document to provide funding in respect of a *defined benefit occupational pension scheme*.

...

Chapter 13

Chapter 13: Financial Resource Requirements for Personal Investment Firms

...

13.3 Financial Resources Test 1 - Own funds

...

#### CALCULATION OF OWN FUNDS

13.3.2 R A *Category A firm's own funds* must be calculated in accordance with tables 13.3.2(1) and (2).

Table 13.3.2(1)

This table forms part of *rule 13.3.2*

FINANCIAL RESOURCES TEST 1 - OWN FUNDS	
Companies	Sole Traders; Partnerships
(1) Paid up ordinary <i>share</i> capital	A Balances on proprietor's or partners'
(2) <i>Share</i> premium account	(5) Capital accounts
(3) Audited reserves (excluding revaluation reserves) ( <u>see 13.3.2AR</u> ) and <i>verified</i> interim net profits	(6) current accounts ( <u>see 13.3.2AR</u> ) (to the extent that the profits are audited and the interim net profits are <i>verified</i> )
(4) Non-cumulative preference <i>shares</i> (if not redeemable by shareholders within 5 years)	
Initial Capital (applicants for authorisation)	

13.3.2A R For the purpose of calculating a *Category A firm's own funds*, the following adjustments apply to audited reserves or, (for non-corporate entities), current accounts figures.

- (1) a *Category A firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
- (2) a *Category A firm* must derecognise any *defined benefit asset*;
- (3) a *Category A firm* may substitute for a *defined benefit liability* its *deficit reduction amount*. The election must be applied consistently in respect of any one financial year.

13.3.2B G A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FSA* the reasons for any difference between the *deficit reduction amount* and any commitment the *firm* has made in any public document to provide funding in respect of a *defined benefit occupational pension scheme*.

...

#### CALCULATION OF FINANCIAL RESOURCES TO MEET TESTS 1, 1A OR 2

13.5.4 R A *Category A firm* must be able to calculate its financial resources at any time on the basis of the balance sheet it could draw up at that time.  
For this purpose:

- (1) ...
- (2) ...
- (3) the assets and liabilities in the balance sheet are also subject to the following adjustments:
- (a) a firm must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
- (b) in respect of a defined benefit occupational pension scheme, a firm must derecognise any defined benefit asset;
- (c) a firm may substitute for a defined benefit liability the firm's deficit reduction amount. The election must be applied consistently in respect of any one financial year.

...

### 13.10 Financial Resources Test 1- Own funds Requirement

...

13.10.2 R A *Category B firm's own funds* must be calculated in accordance with table 13.10(2).

Table 13.10(2).

This table forms part of *rule* 13.10.2

OWN FUNDS	
Companies	Sole Traders: Partnerships
Paid-up <i>share</i> capital (excluding preference <i>shares</i> redeemable by shareholders within 2 years)	Balances on proprietor's or partners'
<i>Share</i> premium account	capital accounts
Audited retained profits (see 13.10.2AR) and <i>verified</i> interim net profits	current accounts (see 13.10.2AR)
Revaluation reserves	Revaluation reserves
Short-term subordinated Loans	Short-term subordinated loans
<i>Debt capital...</i>	

13.10.2A R For the purpose of calculating a *Category B firm's own funds*, the following adjustments apply to audited retained profits or, (for non-corporate entities), current accounts figures.

- (1) a *Category B firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
- (2) a *Category B firm* must derecognise any *defined benefit asset*;
- (3) a *Category B firm* may substitute for a *defined benefit liability* its *deficit reduction amount*. The election must be applied consistently in respect of any one financial year.

13.10.2B G A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FSA* the reasons for any difference between the *deficit reduction amount* and any commitment the *firm* has made in any public document to provide funding in respect of a *defined benefit occupational pension scheme*.

#### CALCULATION OF FINANCIAL RESOURCES TO MEET TESTS 1, 1A OR 2

- 13.12.3 R
- (1) ...
  - (2) ...
  - (3) the assets and liabilities in the balance sheet are also subject to the following adjustments:
    - (a) a *Category B firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
    - (b) in respect of a *defined benefit occupational pension scheme*, a *Category B firm* must derecognise any *defined benefit asset*;
    - (c) a *Category B firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year.

#### APPENDIX 13 (1)

#### Defined terms for Chapter 13

...



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

(1) ...

(e) ~~it has a participating interest (as defined in section 260 of the Companies Act 1985) (Participating interests) in S;~~  
and

(i) it has the power to exercise, or actually exercises, a dominant influence or control over S; or

(ii) it and S are managed on a unified basis; or ...

(f) ...

## Annex G

### Amendments to the Supervision manual

In this Annex, underlining indicates new text and striking through indicates deleted text. For the convenience of readers it is in three parts.

#### Part 1: amendments relating to Banks

SUP 16 Annex 2G form B7

...

#### CURRENT YEAR'S PROFIT AND LOSS

...

##### 4.1 Provisions for bad and doubtful debts

Suspended interest should not be included here, nor should suspended interest be included within item 1.1. This item should equal item 10.3. Specific/individual and General/collective should be as per the branch balance sheet.

...

#### MEMORANDUM ITEMS

##### Provisions against bad and doubtful debts

##### 10.1 Previous balance

Show the balance outstanding on the specific/individual and general/collective provisions account at the end of the previous accounting year relating to debts considered bad or doubtful. Do not include provisions made against the value of investments. The date to which the balance refers should be shown in the space provided.

...

##### 10.3 Charge/credit to profit and loss account

... The charge or credit for specific/individual provisions should not include the charge or credit for provisions in respect of suspended interest (unless it is the practice of the reporting institution to show suspended interest as interest receivable in the P&L account).

...

##### 10.6 Other

Enter any other items, including exceptional provisions and transfers between general/collective and specific/individual provisions.

SUP 16 Annex 2G form BSD3

## SECTION A: BANKING BOOK

### ASSETS

...

A90 Loans secured by mortgage(s) on residential property

...

“Fully secured” means that the value of the property is greater than or equal to the value of the loan (ie a maximum loan to value ratio of 100%). Whilst there is no requirement for reporting institutions to revalue properties on a regular basis, where such valuation has been made and it is found that the loan to value ratio exceeds 100%, such loans should be weighted at 100% (and reported in item A100). (However, if the shortfall in the security value is fully covered by a specific/individual provision, the net amount of the exposure may continue to be weighted at 50%). Conversely, where revaluation indicates that the loan to value ratio has fallen to 100% or less, the loan may be weighted at 50% and reported in item A90.

...

### A120-A190 INVESTMENTS

Report securities, ~~together with any associated accrued interest~~ using the appropriate valuation methodology, with an original maturity of over one year such as equities, eurobonds and FRNs (instruments with an original maturity of one year or less should be reported in items A50-A110). All securities (including British Government stocks) should be reported on a contract day basis, with the payments due or receivable in respect of such transactions to be shown gross in items A760 and A40. Only long positions in securities should be reported in this section of the return (see SGN27). Where the security is being accounted for on a cost or amortised cost basis and it is not possible to identify separately interest accruals they should be reported in item A260 in the appropriate risk weighting band.

...

A120 Central governments and central banks

...

Only holdings of certificates of tax deposit should be reported in the 0% band together with any interest accruals on holdings of securities and debt instruments where the issuer is a Zone A central government or central bank or where the issuer is a Zone B central bank or government and the security is in the local currency of the issuer, accounted for on an accruals basis. For the determination of the appropriate weight band for other securities held, see SGN15. Where the security is being accounted for on a cost or amortised cost basis and it is not

possible to identify separately interest accruals they should be reported in item A260 in the appropriate risk weighting bands.

...

## LIABILITIES

### CORE CAPITAL - TIER 1

...

A500 Reserves

...

A500.2 Disclosed prior years reserves (excluding item A580), disclosed current year's positive movement on reserves and negative movements on reserves

Report the disclosed, undistributed balance on profit and loss account attributable to previous years (ie revenue reserves), reserves arising from exchange rate translation differences and other reserves (eg capital redemption reserves and capital gifts). Do not report reserves arising from the revaluation of fixed assets; such reserves should be shown under item A580. ~~Report here any adjustment in respect of dividends which are not covered by current year's profit verified by external audit.~~

...

Also report any net unrealised losses on equities held in the available-for-sale financial assets category; gains should be reported under item A580.

Do not report:

- (i) any items relating to unrealised gains or losses on cash flow hedges of financial instruments measured at cost or amortised cost;
- (ii) any unrealised gains or losses on debt instruments held in the available-for-sale category;
- (iii) any unrealised gains or losses, which are not attributable to changes in a benchmark interest rate, arising when a bank, upon initial recognition, designates its financial liabilities as at fair value through profit or loss.

These items should be reported at A670 as they do not form part of regulatory capital.

Adjustments in respect of a *defined benefit occupational pension scheme* are to be applied as follows:

- a) any *defined benefit asset* must be deducted from this item and reported in A760.2;
- b) a firm may substitute for its *defined benefit liability* its *deficit reduction amount*. Any difference between the *defined benefit liability* and the *deficit reduction amount* should be reported in A760.2.

A500.3 Current year's retained profit verified by external audit

...

~~Pension fund assets arising from either a pension fund surplus or deficiency should be deducted from this item. Pension fund liabilities arising from pension fund surpluses should be added; whereas pension fund liabilities arising from pension fund deficiencies should not be added back but should be added to item A760.2.~~

...

## SUPPLEMENTARY - TIER 2

A580 Fixed asset revaluation reserves

Report reserves relating to the revaluation of fixed assets. Report also shares issued by the capitalisation of property revaluation reserves after 1 January 1992. Also report any net unrealised gains on equities held in the available-for-sale financial assets category.

A590 General/collective provisions

Report general/collective provisions that are held against possible or latent losses but where the losses have not as yet been identified. Provisions earmarked or held specifically against lower valuations of particular claims or classes of claims should not be reported here, but netted against the value of the asset against which they have been made (see SGN6). This item should include any general/collective provisions against the value of investments.

...

## ADJUSTMENT TO CAPITAL (see ANNEX 1 for details of calculation)

A621 Excess general/collective provisions

...

## OTHER CAPITAL

...

A670 Other capital

...

Report items relating to:

- (i) any unrealised gains or losses on cash flow hedges of financial instruments measured at cost or amortised cost;
- (ii) any unrealised gains or losses on debt instruments held in the available-for-sale financial assets category; and

- (iii) any unrealised gains or losses, which are not attributable to changes in a benchmark interest rate, arising when a bank, upon initial recognition, designates its financial liabilities as at fair value through profit or loss.

Report preference shares ...

#### OTHER NON-CAPITAL LIABILITIES

...

A760 Other

...

Include also any difference between a *defined benefit liability* and the bank's *deficit reduction amount* liabilities arising in respect of a *defined benefit occupational pension scheme* pension scheme deficiencies; and any *defined benefit asset* which has been removed from item A500.2 those arising in respect of a pension fund surplus should be included under item A500.3.

...

#### APPENDIX A-IV - CURRENT YEAR'S PROFIT & LOSS ACCOUNT

##### EXPENSES

...

170 Provisions for dividends

For returns covering less than a year, only those dividends declared in the period should be reported ~~provision should be made for an appropriate portion of the estimated total dividend to be paid for the year.~~

#### APPENDIX A-V - PROVISIONS AGAINST BAD AND DOUBTFUL DEBTS AND INVESTMENTS

10 Previous balance

Show the balance outstanding on the specific/individual and general/collective provisions account at the end of the previous accounting year relating to debts considered bad or doubtful. From end December 2001, this should include provisions made against the value of investments, where these are not reported on a fair value basis. The date to which the balance refers should be shown in the space provided.

20 Adjustments for acquisitions/disposals

Enter any adjustments made as a result of an acquisition or disposal of a subsidiary company the balance sheet of which includes specific/individual or general/collective provisions and is included in the consolidation for the particular return. Where the net adjustment is negative, report the amount with a minus sign (not brackets).

...

90 - 150 Specific/individual provisions against bad and doubtful debts

In the relevant boxes, show the assets (by risk weights) against which specific/individual provisions have been made. Total specific/individual provisions (item 150) should equal the total of items 90 to 140. Include in column 1 above earmarked general/collective provisions which are in the nature of specific/individual provisions. Such cases should be agreed with the FSA. All figures should be positive. Specific/individual provisions against the value of investments should be reported in items 170-230.

...

BSD3 SECTION B: TRADING BOOK FOR SOLO BANK AND LINE BY LINE CONSOLIDATED ENTITIES

...

Specific/Individual Provisions

7 All items reported for the purpose of calculating the capital requirement for counterparty risk (items B10 to B100) should be reported net of any specific/individual or earmarked general/collective provisions made.

...

SUP 16 Annex 2G form LE3

Large Exposures (Form LE3)

...

An exposure

See SGN9. You should monitor and report large exposures on an unconsolidated/solo-consolidated basis and, if agreed with us, a consolidated basis. You should measure an exposure as the amount at risk arising from the total of your business to a counterparty, after deducting specific/individual bad debt provisions and eligible collateral.

...

The amount at risk

...

You should calculate exposures ~~in line with UK generally accepted~~ using the accounting practice principles you use for published financial statements. However, in certain cases you may wish to use an alternative accounting practice. If this is the case, you should talk to us to determine whether reports are acceptable on that basis. The accounting practice you use to report exposures should, unless otherwise stated below, be the same as the one you use to calculate your capital base.

...

Reducing an Exposure

...

## Bad debt provisions

You should report in column B the book value gross of specific/individual and earmarked general/collective provisions for bad and doubtful debts. Similarly, where an exposure is marked to market, the valuation should be gross of any specific/individual provisions. However, you should report such provisions in column C. You should also report exposures net of write-offs that have occurred since the last reporting date. You should report these write-offs in a letter to your usual supervisory contact.

...

SUP 16 Annex 2G form LR

## LIQUIDITY RETURN (FORM LR)

### Provisions

24 Items should be reported net of specific/individual provisions. General/collective provisions should not be recorded on this return.

...

SUP 16 Annex 2G Supervisory Guidance Notes (SGN)

...

### Specific/individual provisions

6 All loans, advances, bills and securities (and also off-balance sheet items) reported on the capital adequacy returns should be included net of any specific/individual or earmarked general/collective provisions made. Off-balance sheet items should also be reported net of specific/individual provisions, although the amount of such provisions should be included in item A750 on Form BSD3. For large exposures purposes, the exposures should be reported gross of provisions for bad and doubtful debts.

...

### Closely related counterparties

12 ...

~~An undertaking is the parent undertaking of another undertaking (a subsidiary undertaking) if any of the following (from section 258, Companies Act 1985) apply-~~

~~(a) It holds a majority of the voting rights in the undertaking.~~



- ~~(b) It is a member of the undertaking and has the right to appoint or remove directors holding a majority of the voting rights at meetings of the board on all, or substantially all, matters.~~
- ~~(c) It has the right to exercise a dominant influence over the undertaking:
 
  - ~~(i) — by virtue of provisions contained in the undertaking’s memorandum or articles; or~~
  - ~~(ii) — by virtue of a control contract. The control contract must be in writing and be of a kind authorised by the memorandum or articles of the controlled undertaking. It must also be permitted by the law under which that undertaking is established.~~~~
- ~~(d) It is a member of the undertaking and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in the undertaking.~~
- ~~(e) It has a participating interest in the undertaking and:
 
  - ~~(i) it actually exercises a dominant influence over the undertaking; or~~
  - ~~(ii) it and the undertaking are managed on a unified basis.~~~~
- ~~(f) A parent undertaking is also treated as the parent undertaking of the subsidiary undertakings of its subsidiary undertakings.~~

Connected counterparties

13 Parties connected to the reporting institution comprise:-

- (i) other group companies<sup>3</sup>, excluding those companies which are included in the consolidation on a particular return;

...

---

<sup>3</sup>The definition of group companies used for supervisory reporting is that set out for “group undertakings” in section ~~262~~ 259(5) of the Companies Act 1985 as amended by the Companies Act 1989, together with any associated companies that are consolidated with the institution for reporting purposes, or that would be consolidated but for the fact that they are supervised by another UK supervisory authority. (For definitions of parent and subsidiary undertakings refer to section 258 of the Companies Act 1985 as amended by the Companies Act 1989 implementing Article 1(1) of the Seventh Company Law Directive (83/349/EEC), referred to in Articles 1(12) and 1(13) of the Banking Consolidation Directive (2000/12/EC).)

...

## Part 2: amendments relating to Building Societies

Sup 16 Annex 4G Form MFS1

### INTRODUCTION: GENERAL NOTES ON THE RETURN

...

#### 3. Accounting conventions

Unless advice is given to the contrary in these Guidance Notes, the return should be compiled using standard accounting practice and in accordance with accounts regulations made under the 1986 Act.

The return ~~was has been~~ designed with the aim of harmonising line items wherever possible with ~~the relevant schedules of the those required under~~ 1998 accounts regulations, ~~and as used in societies' published and internal accounts. In many instances line items reflect the basis adopted in the 1998 accounts regulations.~~ For those societies whose financial reporting base is International Accounting Standards this return will not fully reflect the format of their published accounts.

As the data collected in this return is utilised to support both prudential supervision and provision of statistical sector aggregates to the Bank of England and the Office for National Statistics for Monetary Aggregates there are a number of areas where the guidance notes require data to be provided based on contractual interest rates rather than effective interest rates.

...

#### 7(i) Positions to be reported gross

In general, liabilities and assets should be shown gross, and not netted off. Thus an account which moves from credit to debit will move from one side of the balance sheet to the other.

A notable exception to this however concerns the reporting of loan assets (eg in tables A, B and F) which satisfy the conditions for non-consolidation of an SPE, derecognition or "linked presentation" under set out in FRS5. Such assets should be shown in the balance sheet net of linked funding and also on this basis in table F(1). But in the special analysis in section F9 (table F(2)) they should be shown on a gross basis.

#### 7(ii) Accrued interest

Accrued interest is identified explicitly in the balance sheet under specific subheads. Analysis elsewhere on the return may require either the inclusion or exclusion of accrued interest, but this is indicated on the face of the return as appropriate. Accrued interest should always be calculated using the contractual interest rate.

...

## SECTION B: BALANCE SHEET: Liabilities

...

B1 - B4. Interest accrued

This should be shown gross and calculated using the contractual interest rate.

B1. SHARES

This covers shares as referred to in Section 8 of the 1986 Act.  
It should include:

- (a) ...
- (d) interest credited to accounts (calculated using the contractual rate)

...

...

B2. DEPOSIT AND DEBT SECURITIES

This is a breakdown of liabilities in respect of deposits accepted by the society (including the issue of debt securities), subject to the limitations in Section 8 of the 1986 Act. Deposits should always be reported at their cost value. Debt securities should be reported using the value included in the financial statements.

...

B2.14-18 Debt Securities

Debt securities should be reported using the value included in the financial statements. Where this is on an accruals basis, Deep discounted bonds should be included at issue/purchase price with the "discount" accruing in interest accrued at item B2.19.

B3: CAPITAL

...

B3.5 Other capital – covers capital not described above, and in particular new forms of capital that may be approved in the future but which do not qualify for inclusion in any of items B3.2 or B3.4. In the case of a return completed for a subsidiary undertaking all capital provided by the parent society should go here. Financial results from cash flow hedges and any unrealised gains or losses on available-for-sale financial assets should be reported here.

...

B4 OTHER LIABILITIES includes

...

B4.5 Other includes trade creditors and deferred income; provisions for liabilities; ~~and charges~~ balance sheet amounts relating to fair value hedges and any other effects of applying International Accounting Standards which have not been included within the relevant liability categories above.

...

## SECTION B: BALANCE SHEET: Assets

### B6. LIQUID ASSETS

General Liquid assets in this section of the return are those assets shown as liquid assets under the relevant schedules of the Accounts Regulations ~~and in a society's published and other accounts~~. Liquid assets in the balance sheet (and in table A) are not the same as prudential liquidity, which is analysed in table E.

...

B6.2 Deposits with central banks refers to the Bank of England in the UK and equivalent institutions in other countries. These deposits should be recorded on a contractual basis.

B6.3 Bank Deposits

Report these on a contractual basis and should include:

...

Insert the following before B6.5:

#### B6.4 – B6.11

These sections should be completed in accordance with the accounting principles applicable to these items in the balance sheet of a society.

...

B6.12 Other liquid assets: report these on a contractual basis and includes those with:

...

B6.13 Interest accrued

Only interest accrued on items which are reported in sections B6.2 to B6.12 on a contractual basis should be reported. Where items are reported using market values the interest element should be reported in the appropriate section.

B7 LOANS AND INVESTMENTS

...

All balances entered should be reported on a cost basis and only take ~~bring~~-into account interest (calculated using the rate applied to the loan account) which is due at the reporting date: interest in respect of the remainder of the society's financial year should be excluded since it is not due at the reporting date. Provisions for bad and doubtful debts should not be deducted from individual line items B7.1-7.4 and each of these asset line items should be shown 'gross'. The amount of provisions should be shown separately (B7.6). Balances will however take account of any amounts written off loan assets as shown in the transaction table in Section F.

...

B7.4 Investments should be reported at market value except where they do not have a quoted market price in an active market and whose fair value cannot be reliably measured. In these cases the society should continue to regard investments as being ~~are~~ the aggregate amount outstanding in respect of:

...

B7.6 Provisions: cover general/collective and specific/individual and refers to amounts prepared on a basis consistent with the same items presented in the published accounts. The amount shown should be updated throughout the year whenever updates are made to provisions charged in the Income and Expenditure Account.

...

B10. OTHER ASSETS includes

- (a) trade debtors
- (b) any other item for which payment is due to the society but has not yet been received
- (c) all other assets not shown elsewhere, including all adjustments applied to financial asset values to comply with prudential reporting requirements.

...

## SECTION E: LIQUID ASSETS

E1. REALISABLE WITHIN

- ...
- (i) Balances at the end of the month: as per balance sheet  
Show amounts in this column on the same basis as included in the balance sheet, but in table E include accrued interest along with each line item (in the balance sheet it appears as a separate amount where the asset has been recorded on a contractual basis).
- (ii) Intermediate workings  
....  
Market value only applies to gilts, and means the market value at the month end, but before any discounting is applied. This will be the same as the balance sheet figure where market values have been adopted.

...

## SECTION F: LOAN AND INVESTMENTS

...

### F9 LOAN BOOK ACQUISITIONS/SALES AND LOANS SECURITISED

- ...
- (iii) "loans securitised" represents balances on any loans that the society (or subsidiary undertaking in the case of MFS2 reporting) has "securitised" in the month, where "securitised" has the same meaning as described in the Prudential Guidance on Securitisation [Chapter 10 of Volume 1 of the Interim Prudential Source Book ("IPSB") for Building Societies]. ~~It includes balances on loans subject to securitisation transactions qualifying either for "linked presentation" or "derecognition" methods of accounting.~~

The final column "balance at end month on loan assets subject to nonrecourse funding" represents all such loan assets (and not just the amount treated as transactions in the month), and requires the "gross amount" of such loan assets to be reported against relevant line item categories. The "gross amount" is the amount of any such loan that, ~~under the "linked presentation" method of accounting,~~ would be shown in a society's published or other balance sheet (but not Financial Services Authority returns) as X in the example below:

gross loan asset	= X
less non-recourse funding	= Y
net loan asset	= X-Y

Sup 16 Annex 4G Form QFS1

## INTRODUCTION: GENERAL NOTES ON THE RETURN

...

### 3. Accounting conventions

Unless advice is given to the contrary in these Guidance Notes, the return should be compiled using standard accounting practice and in accordance with accounts regulations made under the 1986 Act.

The return ~~was has been~~ designed with the aim of harmonising line items wherever possible with the relevant schedules of the those required under 1998 accounting regulations, and as used in societies' published and internal accounts. In many instances line items reflect the basis adopted in the 1998 accounting regulations. For those societies whose financial reporting base is International Accounting Standards this return will not fully reflect the format of their published accounts.

...

5(ii) Subsidiary undertakings

Columns headed "subsidiary undertakings" means the total in respect of all such bodies which are required to be fully consolidated in group accounts for prudential regulation ~~(e.g. published accounts)~~

5(iii) Group (consolidated)

Columns headed "Group (consolidated)" should be compiled in line with Prudential Guidance on Solvency ~~on a basis equivalent to that used in preparing published Group figures~~. The figures under "Group" will not necessarily be the total of those under "society" and "subsidiary undertaking" because of consolidation adjustments.

...

8 Specific items

8(i) Positions to be reported gross

In general, liabilities and assets should be shown gross, and not netted off. Thus an account which moves from credit to debit will move from one side of the balance sheet to the other.

A notable exception to this however concerns the reporting of loan assets which are subject to required to satisfy the conditions for non-consolidation of an SPE, derecognition or "linked presentation" under set out in FRS5. Such assets should be shown in the balance sheet net of linked funding and also on this basis in other tables where balances are reported on the same basis (e.g. F, G, H, I as relevant).

...

10 Overseas subsidiary undertakings

Should be treated as they would for the purposes of the society's published accounts, ~~(e.g. attributing such overseas assets and liabilities to the relevant balance sheet items used in the Accounts Regs.)~~

11 Subsidiary undertakings: non-coterminous financial year ends:

...

Whereas the accounting standards Accounts Regulations permits a lag of up to 3 months in annual data, the more frequently collected quarterly data needs to be more time-relevant and, where possible, societies should provide information on subsidiaries for the society's actual quarter rather than lagged by up to 2 months.

SECTION A: BALANCE SHEET

...

3 ...

Statutory Percentages (Nature Limits)

...

### A3 Capital

This category will include:

- (i) any unrealised gains or losses on assets held in the available-for-sale financial assets category, and
- (ii) gains or losses on cash flow hedges of financial instruments measured at cost or amortised cost.

### A5 Other Liabilities

This category should include all liabilities measured at fair value not included in any other liability category on the return.

### A12 Other Assets

This category should include all assets measured at fair value not included in any other asset category on the return.

The purpose of lines items A14 and A15 is to report the actual value at the quarter end (and the expected value for the current financial year end) of the statutorily defined percentages related to the funding and lending nature limits.

A14 ...

## SECTION B: INCOME AND EXPENDITURE ACCOUNT

~~Items should be compiled on the same basis as specified in the Accounts Regulations [1998]. See also Guidance Notes on AFS1 (Table B).~~

### B6.2 Administrative Expenses: Other (inc. appointed agents)

"Appointed agents" refers to those properly appointed by the society to act as its agent mainly for the purpose of obtaining retail funding or making loans.

The amount is the cost to the society of commissions (e.g. on shares or deposits from individuals) and any other payments made by the society to its appointed agents.

~~This amount is included within the other expenses sub-head of Administrative Expenses in published accounts under the Account Regulations and is shown similarly on the return.~~

...



## B17-19 Reconciliation of net Profit/(Loss) with changes in reserves

The purpose of these items is to show the analysis of changes in reserves, excluding revaluation reserves, during the relevant period, and the reconciliation is

$$B19 \text{ must equal } (B16 + B17 + B18)$$

~~"Reserves" has the same meaning as in the Accounts Regs and hence excludes revaluation reserves.~~

## SECTION C: INCOME AND EXPENDITURE ACCOUNT– Further analysis

...

### C1.3 Net profit/(loss) on financial operations

~~The This Accounts Regulations define this category as including includes:~~

- (i) ...
- (ii) ...
- (iii) unrealised gains and losses recorded in the income and expenditure account in respect of assets and liabilities which have been measured on a fair value basis.

## SECTION D: CAPITAL AVAILABLE: Own Funds

...

### TIER I CAPITAL

#### D1.1 Reserves at start of year

Reserves exclude revaluation reserves which are to be shown at D2.1.

Report any net unrealised losses on equities held in the available-for-sale financial assets category; gains should be reported under item D2.5

Do not include any items relating to gains or losses on cash flow hedges of financial instruments measured at cost or amortised cost nor any unrealised gains or losses on debt instruments held in the available-for-sale category; such items should be reported under D2.5.

In respect of a defined benefit occupational pension scheme:

- (i) any defined benefit asset should be deducted from this item and reported in D2.5, but
- (ii) in the calculation of own funds a society may substitute for a defined benefit liability its deficit reduction amount. The difference between the defined benefit liability and the deficit reduction amount should be reported in D2.5.

...

#### D1.4 Intangible fixed assets

Should be deducted. It includes, for example, goodwill to the extent that it is already included in the balance sheet (and hence already included in reserves). ~~See also fuller details for this item in the Accounts Regs.~~

...

#### TIER II CAPITAL

...

#### D2.2 General/collective provisions for bad debt

General/collective provisions should be included on the basis set out in the relevant Annex of the P/G.

...

#### D2.5 Other tier II

Any tier II capital resource that may be permitted in the future and which does not fall to be included under any of the above sub heads. This should include any gains or losses on cash flow hedges and gains or losses on assets held in the available-for-sale financial assets category EXCEPT net unrealised losses on equities which should be reported under item D1.1.

Report also here any difference between the society's defined benefit liability and its deficit reduction amount in respect of a defined benefit occupational pension scheme where the society has elected to substitute the deficit reduction amount for the defined benefit liability in its calculation of own funds. Report also any defined benefit asset which has been removed from item D1.1.

Also include here under "group" columns only, the amount of any allowable minority interests that count as Tier II.

#### D2.76 Amounts in excess of Tier II limits

...

Additionally this section should include the following items included in D2.5:

(iii) gains or losses on cash flow hedges of financial instruments measured at cost or amortised cost;

(iv) any unrealised gains or losses on debt instruments held in the available-for-sale financial assets category;

(v) any difference between the society's defined benefit liability and its deficit reduction amount in respect of a defined benefit occupational pension scheme; or

(vi) any defined benefit asset.

...

D3 Deductions from Tier I and Tier II

D3.1 Deductions not shown elsewhere

...

Also include deductions (described in P/G) in respect of the following: life and general insurance companies, mortgage indemnity insurance captives, securitisations, etc.

Adjustments recorded here should also include any unrealised gains and losses (which are not attributable to changes in a benchmark interest rate) arising when a building society, upon initial recognition, designates its financial liabilities as at fair value through profit or loss.

## SECTION F: CAPITAL: Solvency Ratio

...

On balance sheet items

Details of risk asset weights are given in an Annex of the P/G.

All loan asset balances in table F should be shown net of specific or individual provisions (see below).

...

Columns      Asset amount and Weighted amounts

Columns headed "asset amount" should show the nominal asset figures (including accrued interest). For "on balance sheet" items totals of relevant categories (e.g. liquid assets) should agree with amounts shown in the balance sheet table A (except in the case of loan assets, where balances should be shown after the deduction of specific or individual provisions), unless of course "solo consolidation" or "exclusion from consolidation" applies to table F. For "off balance sheet" items the

nominal asset amount is the amount of principal involved (which in the case of F6.3 to F6.6 is the amount prior to the application of any credit conversion factor).

## SECTION L, EXPOSURE ANALYSIS: Large exposures - Group

...

### 3. (j) Specific or individual provisions

This is to be the amount of any specific or individual provision which has been included in the income and expenditure account in respect of the relevant lending or investment.

## Sup 16 Annex 4G Form QFS2

## SECTION C: UK GOVERNMENT STERLING SECURITIES

...

### C1-3 TRANSACTIONS (Columns)

Points on individual columns are:

...

- (v) Balances at end quarter is given on two bases:
- (a) Book value - which should reconcile with the previous columns
  - (b) Market value - which provides a bench-mark for compilation of sector balance sheets. This may be the same as book value if the accounts have been compiled on a market value basis.

...

## Sup 16 Annex 4G Form AFS1

## INTRODUCTION: GENERAL NOTES ON THE RETURN

...

### 3. Accounting conventions

Unless advice is given to the contrary in these Guidance Notes, the return should be compiled using standard accounting practice and in accordance with accounts regulations made under the 1986 Act.

The return ~~was has been~~ designed with the aim of harmonising line items wherever possible with the relevant schedules of the those required under 1998 accounts regulations, and as used in societies' published and internal accounts. ~~In most instances line items reflect the basis adopted in the 1998 accounting regulations.~~ For those societies whose financial reporting base is International Accounting Standards this return will not fully reflect the format of their published accounts. Given the existence of detailed "definitions" in the Accounts Regs (in the form of particular

treatments to be adopted in compiling balance sheet and income and expenditure accounts) and also guidance in the BSA's Annual Accounts Manual, sections A and B of these Guidance Notes deal only with a limited number of line items where additional notes are thought likely to be needed.

...

5(ii) Subsidiary undertakings

Columns headed "subsidiary undertakings" means the total in respect of all such bodies which are required to be fully consolidated in group accounts for prudential regulation (~~e.g. published accounts~~)

5(iii) Group (consolidated)

Columns headed "Group (consolidated)" should be compiled in line with Prudential Guidance ~~on a basis equivalent to that used in preparing published Group figures.~~

8. Specific items

8(i) Positions to be reported Gross

In general, ~~Accounts Regulations indicate that~~ amounts in respect of items representing assets or income may not be set off against amounts in respect of items representing liabilities or expenditure, subject to certain exceptions relating to financial operations and to provisions and amounts written off which are dealt with in paragraphs B5, B9 and B10 of these Guidance Notes.

A notable exception to this however concerns the reporting of loan assets which ~~are subject to~~ should satisfy the conditions for non-consolidation of an SPE, derecognition or "linked presentation" under FRS5. Such assets should be shown in the balance sheet net of linked funding and also on this basis in other tables where balances are reported on the same basis (e.g. G).

...

## SECTION A: BALANCE SHEET: LIABILITIES

A2 Deposits and debt securities

Although this is not a specific sub-head in the published accounts ~~Accounts Regs~~, it is used for convenience to bring together three sources of funding other than "shares".

...

## SECTION B: INCOME AND EXPENDITURE

...

B5 Other income and charges

Although no longer a sub-head in the published accounts Accounts Regs, it has been retained since all the component items remain.

### Part 3: amendments relating to insurance and mortgage intermediaries

Sup 16 Annex 18BG Notes for completion of the Retail Mediation Activities Return ('RMAR')

...

Section D: Regulatory Capital

...

Section D1: guide for completion of individual fields

...

Eligible capital (mortgage and non-investment insurance)	
Incorporated firms	
Share capital	...
Audited reserves	<p>These are the audited accumulated profits retained by the <i>firm</i> (after deduction of tax and dividends) and other reserves created by appropriations of share premiums and similar realised appropriations. Reserves also include gifts of capital, for example, from a <i>parent undertaking</i>. If reserves have not been audited this field should be zero.</p> <p><u>The audited reserves figure is subject to the following adjustments, where appropriate:</u></p> <p>(a) <u>any unrealised gains must be deducted or, where applicable, any unrealised losses added back in on cash flow hedges of financial instruments measured at cost or amortised cost;</u></p> <p>(b) <u>any unrealised gains must be deducted or, where applicable, any unrealised losses added back in on debt instruments held in the available-for-sale financial assets category;</u></p> <p>(c) <u>in respect of a defined benefit occupational pension scheme, any defined benefit asset must be derecognised;</u></p> <p><u>A firm may substitute for a defined benefit liability the firm's deficit reduction amount.</u></p>

...

Sup 16 Annex 19BG Notes for the completion of the Mortgage Lending & Administration Return ('MLAR')

## INTRODUCTION: GENERAL NOTES ON THE RETURN

...

### 5. Accounting conventions

Unless the contrary is stated in these guidance notes, the return should be compiled using generally accepted accounting practice.

However, information in respect of lending (eg balances, advances, interest rates, arrears etc) to be reported in sections D, E, F, G, H and J of the return should not be fair-valued but should report the contractual position (ie as between lender and borrower).

...

### 9. Specific items

#### 9(i) Positions to be reported gross

In general, liabilities and assets should be shown gross, and not netted off (unless there is a legal right of set-off). Thus an account which moves from credit to debit will move from one side of the balance sheet to the other.

A notable exception to this however concerns the reporting of loan assets, which ~~are subject to~~ should follow PRU 9.3.33R – PRU 9.3.35G 'linked presentation' (e.g. under FRS5). Such assets should be shown in the balance sheet net of linked funding and also on this basis in other tables where balances are reported on the same basis. Only sections A3 and D2 require the reporting of such loan assets on a 'gross' basis.

...

## SECTION A: BALANCE SHEET

A1, A2 The balance sheet is intended to reflect the practices used in compiling published or other accounts (e.g. those prepared under the UK Companies Acts), although its format in the *MLAR* (with 'total assets' and 'total liabilities') will not necessarily be the same as that used by *firms* in their regular accounts. However, the differences should only be presentational.

...

A1.6 ...

A1.11 Other current assets should include all assets measured at fair value not included in any other asset category on the return.

A2.1 Shareholders' funds should include any unrealised gains or losses resulting from the fair valuation of available-for-sale financial assets, and any fair value gains or losses arising on cash flow hedges of financial instruments measured at cost or amortised cost.

A2.7 Other liabilities should include all liabilities measured at fair value not included in any other liability category on the return.

A3 ...

...

#### SECTION B: PROFIT & LOSS ACCOUNT

...

B1.2-1.7 Covers a range of income elements which are more closely related to financial activities, including in particular those associated with mortgage lending. In particular B1.7 Other income should include unrealised gains in respect of assets and liabilities which have been measured on a fair value basis.

B1.9-1.13 Covers a range of expenditure elements, including those related to nonfinancial and also to financial (including mortgage related) activities. In particular B1.13 Other expenses should include unrealised losses in respect of assets and liabilities which have been measured on a fair value basis.

...

#### SECTION C: CAPITAL

...

(3) Audited reserves

Audited reserves are audited accumulated profits retained by the *firm* (after deduction of tax, dividends and proprietors' or *partners'* drawings) and other reserves created by appropriations of *share* premiums and similar realised appropriations. Reserves also include gifts of capital, for example, from a parent company. For *partnerships*, audited reserves include *partners'* current accounts according to the most recent financial statement.



The audited reserves figure is subject to the following adjustments, where appropriate:

- (a) any unrealised gains must be deducted or, where applicable, any unrealised losses added back in on cash flow hedges of financial instruments measured at cost or amortised cost;
- (b) any unrealised gains must be deducted or, where applicable, any unrealised losses added back in on debt instruments held in the available-for-sale financial assets category. Any unrealised gains or losses on equities held in the available-for-sale financial assets category should be reported at C1.5;
- (c) in respect of a *defined benefit occupational pension scheme*, any *defined benefit asset* must be derecognised;

A firm may substitute for a *defined benefit liability* the *firm's deficit reduction amount* provided that that election is applied consistently in respect of any one financial year.

...

(6) General/collective provisions

*Firms* should report general/collective provisions that are held against potential losses that have not yet been identified, but which experience indicates are present in the *firm's* portfolio of assets. Such provisions must be freely available to meet these unidentified losses wherever they arise. General/collective provisions must be verified by external auditors and disclosed in the *firm's* annual report and accounts.

...

Treatment of eligible capital items (listed above) in section C1:

...

C1.4 General/collective provisions

C1.5 Other eligible capital: includes

- any other item of eligible capital not required to be included in items C1.1 to C1.4, including any unrealised gains or losses on equities held in the available-for-sale financial assets portfolio.

...

SECTION D1: LENDING – BUSINESS FLOWS AND RATES

...

D2

Loans: Book movements

...

(iii)'loans securitised' represents balances on any loans that the *firm* has 'securitised' in the quarter. It includes balances on loans subject to securitisation transactions ~~qualifying either for the 'linked presentation' or 'derecognition' methods of accounting as described in FRS 5~~ which should follow PRU 9.3.33R – PRU 9.3.35G;

...

The final column 'balance at end quarter on loan assets subject to nonrecourse funding' represents all such loan assets (and not just the amount treated as transactions in the quarter), and requires the 'gross amount' of such loan assets to be reported against relevant line item categories. The 'gross amount' is the amount of any such loan that, ~~under the 'linked presentation' method of accounting,~~ would be shown in a *firm's* published or other balance sheet as X in the example below: ...