

**INTERIM PRUDENTIAL SOURCEBOOK FOR INVESTMENT BUSINESSES
(EXEMPT CAD FIRMS) INSTRUMENT 2007**

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); and
 - (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 1 November 2007.

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)
Interim Prudential sourcebook for Investment Business (IPRU(INV))	Annex A
Interim Prudential sourcebook for Investment Business (IPRU(INV))	Annex B
Prudential sourcebook for Mortgage Firms and Insurance Intermediaries (MIPRU)	Annex C

Citation

- E. This instrument may be cited as the Interim Prudential sourcebook for Investment Businesses (Exempt CAD firms) Instrument 2007.

By order of the Board
25 January 2007

Annex A

Amendments to the Interim Prudential sourcebook for Investment Businesses (IPRU(INV))

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

Amendments to the Contents page:

Chapter

....

9 Exempt CAD firms

...

Amendments to Chapter 1:

...

1.2.5 R Table

This table belongs to *IPRU(INV)* 1.2.4R

<i>Professional firm</i>	Chapters 1 and 2
<i>Securities and futures firm</i> (which is not an ISD <u>a MiFID investment firm</u>) or a category D firm (as defined in <i>IPRU(INV)</i> 10 App1)	Chapters 1 and 3
<u><i>Securities and futures firm</i></u> (which is an <u>exempt BIPRU commodities firm</u>)	<u>Chapters 1 and 3</u>
<u><i>Securities and futures firm</i></u> (which is an <u>exempt CAD firm other than a firm which was subject to the requirements of Chapter 10 before 1 November 2007</u>)	<u>Chapters 1, 3 and 9</u>
The <i>Society of Lloyd's</i> (in relation to <i>underwriting agents</i>) and <i>members' advisers</i>	Chapters 1 and 4
<u><i>Investment management firm</i></u> (which is not an <u>exempt CAD firm</u>)	Chapters 1 and 5
<u><i>Investment management firm</i></u> (which is an <u>exempt CAD firm</u>)	<u>Chapters 1, 5 and 9</u>

<i>Service company</i>	Chapters 1 and 6
<i>Securities and futures firm which is also an ISD a <u>MiFID investment firm</u> or a category D firm (as defined in <u>IPRU(INV) 10 App1</u>) and a <u>local firm</u></i>	Chapters 1 and 10
<i><u>Securities and futures firm (which is an exempt CAD firm and was subject to the requirements of Chapter 10 before 1 November 2007)</u></i>	<u>Chapter 1, 9 and 10</u>
<i>Personal investment firm</i>	Chapters 1 and 13
...	

...

Amendments to Chapter 3:

...

- 3-1 R This chapter applies to a *securities and futures firm* which:
- (a) is not an MiFID investment firm or a ~~category D firm~~;
 - (b) is a securities and futures firm which is an exempt CAD firm and which was not subject to the requirements of chapter 10 before 1 November 2007; or
 - (c) is an exempt BIPRU commodities firm.

...

- 3-6 G The financial resources rules for an exempt CAD firm are set out in IPRU(INV) chapter 9. As such, rules 3-61 to 3-182 do not apply to an exempt CAD firm unless it carries on any regulated activity other than MiFID business (see IPRU(INV) 9.2.3R). An exempt CAD firm remains subject to the non-financial resources rules (rule 3-10 to rule 3-41(9)) contained in this chapter.

...

- 3-10(2) R A *firm* must keep accounting records in such a manner that they are sufficient to show and explain the *firm's* transactions and commitments (whether effected on its own behalf or on behalf of others) and in particular so that these records:

...

- (a) ...
- (b) demonstrate whether or not the *firm* is or was at that time complying

with its *financial resources requirement* or, in the case of an *exempt CAD firm*, its obligations under *IPRU(INV) 9*; and

...

3-60 Firms to which Rules 3-61 to 3-182 apply

...

Exempt CAD firms

3-60(8) R Rules 3-61 to 3-182 do not apply to an *exempt CAD firm*, unless it carries on any regulated activity other than *MiFID business*.

...

Appendix 1 – Glossary of Terms for IPRU(INV) 3

~~*category D firm* means a firm, the only core investment service for which it has permission is receiving and transmitting on behalf of investors orders in relation to one or more of the instruments listed in Section B of the Annex to the *ISD*, and whose permission is subject to a limitation or requirement preventing it from holding client money or clients' assets and for that reason may not at any time place itself in debit with its clients, which benefits from the freedom of establishment or to provide services under Articles 14 or 15 of the *ISD*;~~

...

Amendments to Chapter 5:

...

5.1.1(1)(a) R ...

TABLE 5.1.1(1)(A)		APPLICATION OF CHAPTER 5		
	ISD <i>Firms Exempt CAD firms</i>	OPS <i>Firms</i> (see Note 1 below)	Non-OPS Life Offices and Non-OPS Local Authorities	Individuals admitted to membership collectively
Financial resources rules				
5.2.1(1) to 5.2.7(5)	Yes No (see <u>Note 3 below</u>)	...		

...

...

Note 2 ...

Note 3 The financial resources rules for an exempt CAD firm are set out in IPRU(INV) chapter 9. However, rules 5.2.1(1) to 5.2.7(5) apply to an exempt CAD firm for the purpose of calculating its own funds requirement (see IPRU(INV) 9.2.8R(2)(a)) and if it carries on any regulated activity other than MiFID business (see IPRU(INV) 9.2.3R). An exempt CAD firm remains subject to the non-financial resources rules (rule 5.3.1(1) to rule 5.5.1(1)) contained in this chapter.

....

5.3.1(1) R A firm must ensure that it maintains adequate accounting records and must prepare and submit such reports as are required by the FSA in a timely manner. A firm's records must:

(1) ...

(2) enable the firm to demonstrate its continuing compliance with its financial resources requirements or, in the case of an exempt CAD firm, its obligations under IPRU(INV) 9; and

...

Amendments to Chapter 10:

...

10-B R This chapter applies to a securities and futures firm which is:

(1) an exempt CAD firm (which was subject to Chapter 10 before 1 November 2007); or

(2) a MiFID investment firm, and to a category D firm which is a local firm.

G ...

...

10-C G The financial resources rules for an exempt CAD firm are set out in IPRU(INV) chapter 9. However, rules 10-61 to 10-176 apply to an exempt CAD firm for the purpose of calculating its own funds (see IPRU(INV) 9.2.8R(2)(b)) and if it carries on any regulated activity other than MiFID business (see IPRU(INV) 9.2.3R). An exempt CAD firm remains subject to the non-financial resources rules (rule 10-10 to rule

10-12(6)) contained in this chapter.

...

10-10(2) R A *firm* must keep records in such a manner that they are sufficient to show and explain the *firm's* transactions and commitments (whether effected on its own behalf or on behalf of others) and in particular so that these records:

(a) ...

(b) demonstrate whether or not the *firm* is or was at that time complying with its *financial resources requirement* or, in the case of an exempt CAD firm, its obligations under IPRU(INV) 9; and

...

~~Category D firms~~ Exempt CAD firms

10-60(2) R Rules 10-61 to 10-176 apply to an *category D exempt CAD firm* only for the purpose of calculating its own funds and if it carries on any regulated activity other than MiFID business; ~~except that a corporate finance advisory firm, which is a category D firm must instead comply with rules 3-60(3), 3-62, 10-61 and 10-63.~~

...

10-61(8) R A *firm's* initial capital must be:

(a) ...

(b) for a *category B firm*: € 125,000; or

(c) for a *category C firm*: €50,000; ~~or~~

~~(d) for an *category D firm*: euro 50,000.~~

(d) for an exempt CAD firm which carries on any regulated activity other than MiFID business and a local firm: €50,000.

[Note: Article 67(2) of MiFID and Article 6 of CAD (in relation to a local firm)]

...

10-73(1) R ~~A *firm's*~~ The expenditure requirement for a *local firm* must be 1/4 of its relevant annual expenditure calculated in accordance with (2) to (4) below:

(a) ~~for a *category D firm* which is not responsible for its counterparties' performance: 6/52nds of its relevant annual expenditure calculated in accordance with (2) to (4) below; or~~

- (b) for any other *firm*: 1/4 of its relevant annual expenditure calculated in accordance with (2) to (4) below.

...

Appendix 1 – Glossary of Terms for IPRU(INV) 10

category D firm means a *firm*, the only *core investment service* for which it has *permission* is receiving and transmitting on behalf of investors orders in relation to one or more of the instruments listed in Section B of the Annex to the *ISD*, and whose *permission* is subject to a *limitation or requirement* preventing it from holding *client money* or *clients' assets* and for that reason may not at any time place itself in debit with its *clients*, which benefits from the freedom of establishment or to provide services under Articles 14 or 15 of the *ISD*;

Amendments to Chapter 13:

In the following provisions, references to "Category A firm" are changed to "exempt CAD firm":

- Table 13.1(1) (paragraphs 2 and 3)
- 13.2.1R
- 13.2.2G
- Table 13.A
- 13.3.1R
- 13.3.2R
- 13.3.2AR (1), (2), (3), (4), (5)
- 13.4.1R
- 13.4.2R
- 13.5.1R
- 13.5.2R (1), (2), (3)
- 13.5.4R
- 13.5.4AR
- 13.5.5R
- 13.5.5CR
- 13.6.1R
- 13.6.2R
- 13.6.2AR
- 13.6.2BR
- 13.6.2CR
- 13.6.2DR
- 13.7.2BR
- 13.8.2R
- the definitions of 'Category A1 firm', 'Category A2 firm', 'Category A3 firm' and 'Category B firm' in the IPRU (INV) 13 glossary

- 13.1 R (1) This chapter applies to a *firm* which is a *personal investment firm*.
- (2) ~~Sections 13.1 to 13.8 apply to~~ For a *personal investment firm* which is an ~~Category A~~ exempt CAD firm the following apply:
- (a) sections 13.1 and 13.1A; and
- (b) sections 13.2 to 13.8 or (if prior to 1 November 2007 the *firm* was subject to sections 13.9 to 13.12) 13.9 to 13.12 (see 13.1A.2).
- (3) ...

...

- 13.1.4(1) R (1) *A firm must take out and maintain at all times professional indemnity insurance that is at least equal to the requirements of 13.1.4(2) to 13.1.4(15).*
- (2) Paragraph (1) does not apply to an exempt CAD firm unless it chooses to comply with these rules (see 13.1A).

Policy Terms

13.1.4(2) R ...

...

Limits of Indemnity – IMD insurance intermediary or an exempt CAD firm

- (b) if the firm is an IMD insurance intermediary or an exempt CAD firm that maintains professional indemnity insurance under 13.1A.3(1)(b), appropriate minimum limits of indemnity per year, which are, if the firm is an IMD insurance intermediary, no lower than:
- (i) €1,000,000 for a single claim against the firm; and
 - (ii) €1,500,000 in the aggregate;

[Note: Article 67(3) of MiFID and Article 7 of CAD (see also rule 13.1A.3)]

- (c) if the firm is both an IMD insurance intermediary and an exempt CAD firm that maintains professional indemnity insurance under 13.1A.4(1)(b), appropriate additional limits of indemnity to 13.1.4(2)(b) per year which are no lower than:
- (i) €500,000 for a single claim against the firm; and
 - (ii) €750,000 in the aggregate.

[Note: Article 67(3) of MiFID and Article 8 of CAD (see also rule 13.1A.4)]

Limits of Indemnity – ~~Non-IMD insurance intermediary~~ Other firms

- ~~(e)~~(d) if the firm is not an IMD insurance intermediary or an exempt CAD firm, then the following limits of indemnity apply:
- (i) ...

...

The following text is all new and is not underlined.

After section 13.1 insert section 13.1A as follows:

13.1A Financial resources requirements for an exempt CAD firm

Application

13.1A.1 R This section applies to a *personal investment firm* which is an *exempt CAD firm*.

Initial capital and professional indemnity insurance requirements

13.1A.2 R The financial resources requirement for a *personal investment firm* which is an *exempt CAD firm* is the higher of:

- (1) the requirement that is applied by section 13.1A; and
- (2) (a) the requirement that is applied by sections 13.2 to 13.8; or
(b) (if prior to 1 November 2007 the *firm* was subject to sections 13.9 to 13.12) the requirement that is applied by those sections (but reading references to *Category B firm* as references to the *firm*).

13.1A.3 R (1) A *firm* which is not an *IMD insurance intermediary* must have:

- (a) *initial capital* of €50,000; or
- (b) professional indemnity insurance at least equal to the requirements of 13.1.4(2)(b) and 13.1.4(3) to 13.1.6; or
- (c) a combination of *initial capital* and professional indemnity insurance in a form resulting in a level of coverage equivalent to (a) or (b).

[Note: Article 67(3) of *MiFID* and Article 7 of *CAD* (see also rule 13.1.4(2)(b))]

- (2) If a *firm* chooses to comply with either (b) or (c) above, it must nevertheless have *initial capital* of at least £5,000.

13.1A.4 R (1) A *firm* that is also an *IMD insurance intermediary* must have professional indemnity insurance at least equal to the limits set out in 13.1.4(2)(b) and in addition has to have:

- (a) *initial capital* of €25,000; or
- (b) professional indemnity insurance at least equal to the requirements of 13.1.4(2)(c) and 13.1.4(3) to 13.1.6; or
- (c) a combination of *initial capital* and professional indemnity insurance in a form resulting in a level of coverage equivalent to (a) or (b).

[Note: Article 67(3) of *MiFID* and Article 8 of *CAD* (see also rule 13.1.4(2)(c))]

- (2) If a *firm* chooses to comply with either (b) or (c) above, it must nevertheless have *initial capital* of at least £5,000.

- 13.1.A.5 G A trade-off between *initial capital* and professional indemnity insurance is appropriate such that €1 of *initial capital* is the equivalent of professional indemnity insurance cover of €20 for a single claim against the *firm* and €30 in aggregate.

Ongoing capital requirements

- 13.1.A.6 R A *firm* must, at all times, maintain a combination of professional indemnity insurance and *own funds*, (*own funds* to be calculated in accordance with 13.3.2R), at least equal to the requirements in this chapter for professional indemnity insurance and *initial capital*.

Initial capital

- 13.1.A.7 R A *firm's initial capital* consists of the sum of the following items:
- (1) ordinary *share* capital which is fully paid;
 - (2) perpetual non-cumulative *preference share* capital which is fully paid;
 - (3) *share* premium account;
 - (4) reserves excluding revaluation reserves;
 - (5) audited retained earnings;
 - (6) externally *verified* interim net profits;
 - (7) partners' capital;
 - (8) *eligible LLP members' capital* (in accordance with the provisions of *IPRU(INV)* Annex A); and
 - (9) *sole trader* capital.

Perpetual non-cumulative preference share capital

- 13.1.A.8 R A *firm* may include *preference share* capital in *initial capital* only where any *coupon* on it is not cumulative, and the *firm* is under no obligation to pay a *coupon* in any circumstances.

Audited retained earnings

- 13.1A.9 R When calculating *initial capital*, a *firm* may include its audited retained earnings only after making the following adjustments:
- (1) a *firm* must not recognise the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost;
 - (2) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;
 - (3) a *firm* must not include any unrealised gains from investment property (these should be reported as part of revaluation reserves);
 - (4) where applicable, a *firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but excluding from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

Externally verified interim net profits or current account

- 13.1A.10 R A *firm* may include interim net profits or current account when calculating *initial capital* to the extent that they have been *verified* by the *firm's* external auditor and are net of any foreseeable tax, dividend and other appropriations.
- 13.1A.11 R When calculating *initial capital*, a *firm* may include its partners' capital only after making the following adjustments:
- (1) a *firm* must not recognise the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost;
 - (2) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;
 - (3) where applicable, a *firm* must deduct any asset in respect of *deferred acquisition costs* and add back in any liability in respect of deferred income (but excluding from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

Defined benefit pension scheme: defined benefit liability

- 13.1A.12 R For the calculation of *initial capital*, 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.
- 13.1A.13 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*.

Appendix 13(1)

Defined terms for Chapter 13

initial capital means the initial capital of a *firm* calculated in accordance with 13.1A.7.

In the following text, underlining indicates new text and striking through indicates deleted text.

Amendments to Chapter 14:

...

14.1.1 R Subject to rule 14.1.2, *consolidated supervision* and this chapter apply to a *firm* which is a member of a *group* if:

(1) ...

(b) a *securities and futures firm*, subject to the financial rules in Chapter 10, unless the *firm* is an ~~*category D firm exempt CAD firm*~~;

...

In the following text, underlining indicates new text.

Annex A: LIMITED LIABILITY PARTNERSHIPS: ELIGIBLE MEMBERS' CAPITAL

...

1.5 G The following *rules* allows inclusion of members' capital within a *firm's* capital if it meets the conditions in this annex:

Chapter	<i>IPRU(INV) rule</i>	How <i>eligible LLP members' capital</i> should be treated for the purposes of the <i>IPRU(INV) rule</i>
...
<u>5</u>
<u>9</u>	<u>9.3.1</u>	<u><i>Eligible LLP members' capital</i> may be counted as initial capital within <i>IPRU(INV) 9.3.1</i></u>
10
13	Table 13.3.2(1) Table 13.10(2) <u>13.1A.7</u>	<i>Eligible LLP members' capital</i> may be counted as <i>own funds</i> relating to companies in Table 13.3.2(1) and Table 13.10(2). <u><i>Eligible LLP members' capital</i> may be counted as <i>initial capital</i> within <i>IPRU(INV) 13.1A.7</i>.</u>

Annex B

Amendments to the Interim Prudential sourcebook for Investment Businesses (IPRU(INV))

In this Annex, all the text is new and is not underlined.

Insert the following new chapter as Chapter 9 of *IPRU(INV)*:

Chapter 9: Financial resources requirements for an exempt CAD firm

9.1 Application

9.1.1 R This chapter applies to an *exempt CAD firm* which is:

- (1) an *investment management firm*; or
- (2) a *securities and futures firm*.

9.2 General requirements

9.2.1 G For an *exempt CAD firm*, the *rules* contained within this chapter replace the *rules* in respect of financial resources and financial resources requirements contained within Chapter 3, 5 or 10, as applicable. However, an *exempt CAD firm* must continue to comply with the requirements of Chapter 3, 5 or 10, as applicable, for its non-financial resources related requirements and to the extent it is referred to Chapter 3, 5 and 10 by a *rule* in this chapter.

9.2.2 R A *firm* must be able to meet its liabilities as they fall due.

9.2.3 R An *exempt CAD firm* that carries on any *regulated activity* other than *MiFID business* must also have and maintain at all times financial resources calculated in accordance with the chapter of *IPRU(INV)* to which the *firm* is otherwise subject (Chapters 3, 5 or 10) at least equal to the requirements set out in the relevant chapter.

Initial capital and professional indemnity insurance requirements – exempt CAD firms that are not IMD insurance intermediaries

9.2.4 R (1) A *firm* which is not an *IMD insurance intermediary* must have:

- (a) *initial capital* of € 50,000; or
- (b) professional indemnity insurance covering the whole territory of the *EEA* or some other comparable guarantee against liability arising from professional negligence, representing at least €1,000,000 applying to each claim and in aggregate €1,500,000 per year for all claims; or
- (c) a combination of *initial capital* and professional indemnity insurance in a form resulting in a level of coverage

equivalent to (a) or (b).

[Note: Article 67(3) of *MiFID* and Article 7 of *CAD*]

- (2) If a *firm* chooses to meet the requirements of either (b) or (c) above, it must nevertheless have *initial capital* of at least £5,000.

Initial capital and professional indemnity insurance requirements – exempt CAD firms that are also IMD insurance intermediaries

- 9.2.5 R (1) A *exempt CAD firm* that is also an *IMD insurance intermediary* must comply with the professional indemnity insurance requirements for a *firm* that is not and in addition has to have:
- (a) *initial capital* of €25,000; or
 - (b) professional indemnity insurance covering the whole territory of the *EEA* or some other comparable guarantee against liability arising from professional negligence, representing at least €500,000 applying to each claim and in aggregate €750,000 per year for all claims; or
 - (c) a combination of *initial capital* and professional indemnity insurance in a form resulting in a level of coverage equivalent to (a) or (b).

[Note: Article 67(3) of *MiFID* and Article 8 of *CAD*]

- (2) If a *firm* chooses to meet the requirements of either (b) or (c) above, it must nevertheless have *initial capital* of at least £5,000.

- 9.2.6 G A trade-off between *initial capital* and professional indemnity insurance is appropriate such that €1 of *initial capital* is the equivalent of professional indemnity insurance cover of €20 for a single claim against the *firm* and €30 in aggregate.

Comparable guarantee

- 9.2.7 R (a) If another *authorised person* which has net tangible assets of more than £10 million provides a comparable guarantee, a *firm* can treat it as an alternative to effecting or maintaining professional indemnity insurance pursuant to the rules relating to professional indemnity insurance above.
- (b) If the *firm* is a member of a *group* in which there is an *authorised person* with net tangible assets of more than £10 million, the comparable guarantee must be from that *person*.
- (c) A comparable guarantee means a written agreement on terms at least equal to those required by the *initial capital* and professional indemnity insurance requirements above to finance the claims that might arise as a result of the breach by the *firm* of its duties under

the *regulatory system* or civil law.

Ongoing capital requirements

- 9.2.8 R (1) A *firm* must, at all times, maintain a combination of professional indemnity insurance and *own funds*, (*own funds* to be calculated in accordance with (2)), at least equal to the requirements in this chapter for professional indemnity insurance and *initial capital*.
- (2) (a) If the *firm* is an *investment management firm* its *own funds* must be calculated in accordance with the *rules* in *IPRU(INV)* 5.2.1(1) to 5.2.7(5).
- (b) If the *firm* is a *securities and futures firm* (subject to either Chapter 3 or Chapter 10) its *own funds* must be calculated in accordance with the *rules* in *IPRU(INV)* 10.61(1)(B) to 10-176.

9.3 Calculating initial capital

Initial capital

- 9.3.1 R A *firm's initial capital* consists of the sum of the following items:
- (1) ordinary *share* capital which is fully paid;
 - (2) perpetual non-cumulative *preference share* capital which is fully paid;
 - (3) *share* premium account;
 - (4) reserves excluding revaluation reserves;
 - (5) audited retained earnings;
 - (6) externally *verified* interim net profits;
 - (7) partners' capital;
 - (8) *eligible LLP members' capital* (in accordance with the provisions of *IPRU(INV)* Annex A); and
 - (9) *sole trader* capital.

Perpetual non-cumulative preference share capital

- 9.3.2 R A *firm* may include *preference share* capital in *initial capital* only where any *coupon* on it is not cumulative, and the *firm* is under no obligation to pay a *coupon* in any circumstances.

Audited retained earnings

- 9.3.3 R When calculating *initial capital*, a *firm* may include its audited retained earnings only after making the following adjustments:
- (1) a *firm* must not recognise the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost;
 - (2) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;
 - (3) a *firm* must not include any unrealised gains from investment property (these should be reported as part of revaluation reserves);
 - (4) where applicable, a *firm* must deduct any asset in respect of *deferred acquisition costs* and add back in any liability in respect of deferred income (but excluding from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

Externally verified interim net profits or current account

- 9.3.4 R A *firm* may include interim net profits or current account when calculating *initial capital* to the extent that they have been *verified* by the *firm's* external auditor and are net of any foreseeable tax, dividend and other appropriations.

- 9.3.5 R When calculating *initial capital*, a *firm* may includes its partners' capital only after making the following adjustments:
- (1) a *firm* must not recognise the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost;
 - (2) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;
 - (3) where applicable, a *firm* must deduct any asset in respect of *deferred acquisition costs* and add back in any liability in respect of deferred income (but excluding from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

Defined benefit pension scheme: defined benefit liability

- 9.3.6 R For the calculation of *initial capital*, 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.
- 9.3.7 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.

9.4 Policy terms for professional indemnity insurance

Insurers whose professional indemnity insurance policies can be used

9.4.1 R A *firm* that has professional indemnity insurance in accordance with this chapter must take out and maintain professional indemnity insurance that is at least equal to the requirements of the rule below from:

- (1) an *insurance undertaking* which is authorised to transact professional indemnity insurance in the *EEA*; or
- (2) a person of equivalent status in:
 - (a) a *Zone A country*;
 - (b) the Channel Islands, Gibraltar, Bermuda or the Isle of Man.

Terms to be incorporated in the professional indemnity insurance policy

9.4.2 R The policy of professional indemnity insurance must incorporate terms which make provision for:

- (1) cover in respect of claims for which a *firm* may be liable as a result of the conduct of itself, its *employees* and its *appointed representatives* (acting within the scope of their appointment);
- (2) the minimum *levels of indemnity* per year as set out in the rules relating to professional indemnity insurance above;
- (3) appropriate cover in respect of legal defence costs; and
- (4) cover in respect of *Ombudsman* awards made against the *firm*.

Policies in other currencies

9.4.3 R If a professional indemnity insurance policy is denominated in any currency other than euros, a *firm* must take reasonable steps to ensure that the *limits of indemnity* are, when the policy is effected and at *renewal*, at least equivalent to those required for the purposes of the rules relating to professional indemnity insurance above.

Conditions and exclusions

9.4.4 R A professional indemnity insurance policy must not be subject to conditions or exclusions which unreasonably limit the cover provided (whether by exclusion of cover, by policy excesses or otherwise).

...

APPENDIX 9(1) (INTERPRETATION)

Glossary of defined terms for Chapter 9

Note: If a defined term does not appear in the glossary below, the definition appearing in the Handbook Glossary applies.

<i>initial capital</i>	means the initial capital of a <i>firm</i> calculated in accordance with section 9.3.
<i>own funds</i>	means the own funds of a <i>firm</i> calculated in accordance with rule 9.2.8.
<i>verified</i>	means checked by an external auditor who has undertaken at least to: <ul style="list-style-type: none">(a) satisfy himself that the figures forming the basis of the interim profits have been properly extracted from the underlying accounting records;(b) review the accounting policies used in calculating the interim profits so as to obtain comfort that they are consistent with those normally adopted by the <i>firm</i> in drawing up its annual financial statements and are in accordance with the relevant accounting principles;(c) perform analytical procedures on the result to date, including comparisons of actual performance to date with budget and with the results of prior period(s);(d) discuss with management the overall performance and financial position of the <i>firm</i>;(e) obtain adequate comfort that the implications of current and prospective litigation, all known claims and commitments, changes in business activities and provisioning for bad and doubtful debts have been properly taken into account in arriving at the interim profits; and(f) follow up problem areas of which he is already aware in the course of auditing the <i>firm's</i> financial statements,

and a copy of whose report asserting that the interim net profits are reasonably stated has been submitted to the *FSA*.

Annex C

Amendments to Prudential Sourcebook for Mortgage Firms and Insurance Intermediaries (MIPRU)

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

...

3 Professional indemnity insurance

...

3.1.1 R Application

...

(5) This chapter does not apply to:

...

- (c) ~~a *personal investment firm* that is required by another rule to hold professional indemnity insurance (see *IPRU(INV)* 13.1.4(1))~~ a firm to which *IPRU(INV)* 13.1.4(1) (Financial resource requirements for personal investment firms: requirement to hold professional indemnity insurance) applies; or
- (d) an *exempt CAD firm* to which *IPRU(INV)* 9.2.5R (Initial capital and professional indemnity insurance requirements – exempt CAD firms that are also IMD insurance intermediaries) applies.

...