

# 199

Financial Services Authority

## Miscellaneous amendments to the Handbook (No. 10)

September 2003





# Contents

1	Executive summary	5
2	Proposed amendment to the Glossary	7
3	Proposed amendments to the Interim Prudential sourcebook for Insurers	11
4	Proposed amendments to the Supervision manual and the Interim Prudential sourcebook for Banks	14
5	Proposed amendments to the Conduct of Business sourcebook and the Glossary	21
6	Proposed amendments to the Money Laundering sourcebook and consequential changes	25
7	Proposed amendments to the Collective Investment Schemes sourcebook, the Conduct of Business sourcebook and the Glossary	35
8	Proposed amendments to the Decision making manual	39
9	Proposed amendments to the Complaints sourcebook and the Compensation sourcebook	49
10	Proposed amendments to the Supervision manual and the Credit Unions sourcebook	51
11	Creation of a new sourcebook – the Client Assets sourcebook – and proposed consequential amendments	58
12	Proposed amendments to the Listing Rules	62

- Annex 1:** List of specific consultation questions
- Annex 2:** Proposed amendment to the Glossary
- Annex 3** Proposed amendments to the Interim Prudential sourcebook for Insurers
- Annex 4** Proposed amendments to the Supervision manual and the Interim Prudential sourcebook for Banks
- Annex 5** Proposed amendments to the Conduct of Business sourcebook and the Glossary
- Annex 6** Proposed amendments to the Money Laundering sourcebook and consequential changes
- Annex 7** Proposed amendments to the Collective Investment Schemes sourcebook, the Conduct of Business sourcebook and the Glossary
- Annex 8** Proposed amendments to the Decision making manual
- Annex 9** Proposed amendments to the Complaints sourcebook and the Compensation sourcebook
- Annex 10** Proposed amendments to the Supervision manual and the Credit Unions sourcebook
- Annex 11** Creation of a new sourcebook – the Client Assets sourcebook – and proposed consequential amendments
- Annex 12** Proposed amendments to the Listing Rules

The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by 19 November 2003, except for:

- comments on some of the proposals in Chapter 4 which should reach us by 31 October 2003; and
- comments on Chapter 6 which should reach us by 18 December 2003.

You can send comments by electronic submission using the form on the FSA website (at [www.fsa.gov.uk/pubs/cp/cp199\\_response.html](http://www.fsa.gov.uk/pubs/cp/cp199_response.html)).

Responses by email should be sent to [cp199@fsa.gov.uk](mailto:cp199@fsa.gov.uk).

If you wish to respond by letter, please send your response to the person named at the end of each chapter and set out below.

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Chapter 3: Somia Shafiq, Tel: 020 7066 9318 or Fax: 020 7066 9319

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Chapter 11: Colleen Glendale-Perry, Tel: 020 7066 5412 or  
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Chapter 12: Belinda Burton, Tel: 020 7066 8212 or Fax: 020 7066 8213

If you are responding to several chapters, comments can also be sent to Samar Farrell in the Crime, Handbook, Capital and Groups Department who will distribute the response as appropriate.

All responses to the above people should be sent to:

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**It is our policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise.**



# 1 Executive summary

1.1 This Consultation Paper (CP) invites comments on miscellaneous amendments to the Handbook. It proposes amendments in 11 areas:

- an amendment to the *Glossary*, by adding the Channel Islands Stock Exchange to the list within the definition of “designated investment exchange”;
- changes to two definitions within the *Interim Prudential sourcebook for Insurers* to clarify their meaning;
- amendments to the *Supervision manual*, and the *Interim Prudential sourcebook for Banks*, to correct omissions and to amend and update the guidance on the financial reports required from banks and building societies;
- amendments to the *Conduct of Business sourcebook* to clarify the requirements on keeping records of a customer’s circumstances, and to the *Glossary* definition of “pension transfer” to make clear that transfers to pension buy-out contracts are included within the relevant reporting requirements;
- changes to the *Money Laundering sourcebook* to reflect recent and imminent legislative changes, to clarify particular provisions and to correct minor errors, with consequential changes to other parts of the Handbook;
- amendments to the *Collective Investment Schemes sourcebook* to require the financial statements contained in the annual and half-yearly reports of authorised CISs to comply with the new Statement of Recommended Practice which is expected to be issued by the Investment Management Association on 1 December 2003; there are consequential amendments to the *Conduct of Business sourcebook* and to the *Glossary*;
- amendments to the *Decision making manual* to clarify when settlement discussions and mediation are available to firms and individuals; these

changes follow a review of the pilot mediation scheme which has been successfully running since December 2001;

- amendments to the *Complaints sourcebook* and the *Compensation sourcebook* regarding the process for firms wishing to notify us that they do not deal with eligible complainants or eligible claimants and so are able to claim exemption from some of the requirements of these sourcebooks;
- changes to the *Supervision manual* and the *Credit Unions sourcebook* affecting the credit union annual return, bringing in new provisions regarding loans to credit union officers, rules and guidance on systemic risk from intra-sector loans, on loan periods, on the use of the term “credit union” and on exposure to higher liquidity and operational risk, and on the distinction between borrowing and the acceptance of deposits;
- details of the arrangement of the new *Client Assets sourcebook*, and consequential amendments to other parts of the Handbook; and
- changes to the *Listing Rules* to take account of the new Code on Corporate Governance arising out of the review conducted by Mr Derek Higgs and a review of audit committees led by Sir Robert Smith.

1.2 Each amendment or set of amendments is described in a separate chapter. Each chapter includes an explanation of the proposed amendment, a statement of purpose, a cost benefit analysis (if necessary) and a compatibility statement. Annexes to this CP contain the actual text of the proposed amendments.

1.3 The deadlines for comments on these amendments are:

- 31 October 2003 for the proposals described in paragraphs 4.26 and 4.27;
- 18 December 2003 for the proposals described in Chapter 6;
- 19 November 2003 for all the other proposals.

The proposed amendments in Chapters 2, 5, 6 and 7 may be of particular interest to retail consumers and consumer groups.

The remaining amendments are largely technical amendments, clarifications and corrections and are, on the whole, unlikely to have a direct impact on consumers.

# 2 Proposed amendments to the Glossary

## Introduction

- 2.1 We are proposing to amend the definition of designated investment exchange in the *Glossary* by adding the Channel Islands Stock Exchange (CISX) to the list of designated investment exchanges. We would make this amendment under sections 138 and 157 of the Financial Services and Markets Act 2000.
- 2.2 The text of the proposed amendment described in this chapter is in Annex 2. This amendment is likely to be of interest to UK authorised firms and consumers.
- 2.3 In the guidance published in the *General Provisions* (GEN 2 Annex 1G), we introduced the concept of designated investment exchange for overseas exchanges that do not carry on a regulated activity in the UK and so do not need to apply for recognition as a recognised investment exchange. Designated investment exchanges do not submit themselves to UK regulation and we are not required to supervise them.
- 2.4 Designation facilitates trading by UK authorised firms as under certain rules they may treat transactions effected on a designated investment exchange in the same way as transactions on recognised investment exchanges. An overseas investment exchange seeking designation must apply to us in writing. Under our published guidance in GEN 2 Annex 1G, we determine whether the investment exchange provides an appropriate degree of protection for consumers having regard in particular to:
  - the relevant law and practice, including the regulatory framework in which the investment exchange operates, in the country or territory in which the investment exchange's head office is situated and any other relevant country or territory; and
  - the rules and practices of the investment exchange.

- 2.5 When determining whether to grant or refuse an application for designation, we have regard, among other things, to the applicant's replies to the questionnaire set out in GEN 2 Annex 1G.

### **Proposed amendment**

- 2.6 The CISX applied for designation in December 2001. With the help of the information provided in response to the questionnaire in GEN 2 Annex 1G, we considered the suitability of the exchange for designation against the designation criteria stated in the guidance mentioned above.
- 2.7 As to the CISX's own regulatory environment, the exchange was licensed by the Guernsey Financial Services Commission (GFSC) under the Protection of Investors (Bailiwick of Guernsey) Law 1987 in 1998 to carry on the activity of operating an investment exchange. The GFSC is the home-country regulator and reviews the exchange's business plan and approves any proposed amendments to its rules. The CISX is also subject to on-site as well as off-site supervision by the GFSC. The on-site visits are designed to comply with the International Organisation of Securities Commissions (IOSCO) Principles of Securities Regulation. The rules and practices of CISX are such as to satisfy our concerns in areas such as supervision, membership, price information, clearing and compliance. We consider therefore that the internal regulatory environment of CISX affords an appropriate degree of consumer protection to recommend designation.
- 2.8 With respect to the external regulatory environment in which the CISX operates, we took significant regulatory changes in Guernsey into account to determine whether the exchange provides an appropriate degree of protection for consumers. In addition to their existing legislation on money laundering and insider dealing, the States of Guernsey proposed to amend the Protection of Investors (Bailiwick of Guernsey<sup>1</sup>) Law 1987 to incorporate provisions on market manipulation and market abuse in August 2002. These amendments have been passed by the States of Guernsey and approved by the Privy Council in the UK in July 2003. The Protection of Investors (Bailiwick of Guernsey) (Amendment) Law, 2003 has been brought into effect in August 2003. In consequence, we consider that the regulatory framework in which CISX operates in its home jurisdiction also provides an appropriate degree of consumer protection.
- 2.9 We are satisfied that the regulations and regulatory environment of the CISX offer an appropriate degree of protection for consumers and, therefore, propose to designate the CISX under our rules.

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1 The Bailiwick of Guernsey is Guernsey together with Alderney and Sark

## **Cost benefit analysis**

- 2.10 We consider that the proposed amendment to the Glossary will give rise to cost increases of no more than minimal significance.
- 2.11 Our view is that the direct costs involved for the FSA should result in costs no greater than the addition of the CISX to the list of designated investment exchanges set out in the Glossary. Indeed, we do not supervise such exchanges unlike recognised bodies. As far as UK authorised firms are concerned, it is also not anticipated that there will be material costs arising from the proposed change. We estimate that UK firms effecting transactions on the CISX, may be expected to incur minor IT costs in adjusting their systems to calculate their position risk requirements.
- 2.12 With respect to the benefits of the proposed addition of the CISX to the list of designated investment exchanges, we consider that the designation of the CISX could be regarded as beneficial, in essence, both to UK investors and authorised firms.
- 2.13 The list of designated investment exchanges serves as a way of providing UK investors and their brokers with a reference point to those non-UK exchanges which, while not carrying on a regulated activity in the UK, may have appropriate standards of investor protection.
- 2.14 A second potential benefit of designation is that under certain rules UK authorised firms may treat transactions effected on a designated investment exchange in the same way as transactions on recognised investment exchanges, i.e. on-exchange<sup>2</sup>. The direct consequence of such benefit for firms is that these transactions will attract a significant lower position risk requirement and therefore the costs associated with the latter will reduce.
- 2.15 A further potential benefit of designation is that authorised firms may take advantage of the exemptions granted under Rule 30.10 of the US Commodity Futures Trading Commission's Rules. This allows them to sell investments listed on a designated investment exchange to customers in the USA.

## **Compatibility statement**

### *Compatibility with our regulatory objectives*

- 2.16 The designation of the CISX will provide UK consumers and their brokers with a reference point to the fact that the CISX appears to have appropriate standards of investor protection. We consider that this will contribute in particular to two of our statutory objectives, those of maintaining confidence

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2 For example, see COB 5 Ann 1 E, COB 9.1.35 R and COB 7.11

in the financial system and securing the appropriate degree of protection for consumers. By contributing to these two objectives, it should also help support a third objective, that of reducing financial crime.

*Compatibility with the principles of good regulation*

- 2.17 Two of the principles of good regulation are relevant to this proposal. There are no adverse effects on the other principles.
- 2.18 *That a burden imposed on a person should be proportionate to the benefits from that imposition.* The fact that we assessed the CISX as providing a satisfactory degree of protection for consumers is likely to provide UK consumers and firms with benefits as detailed above. We believe that these benefits are proportionate to the costs arising from the proposed change.
- 2.19 *The international character of financial services and markets and the desirability of maintaining the competitive position of the UK.* The designation of the CISX will enable UK authorised firms to treat transactions on this exchange in the same way as on-exchange transactions on recognised investment exchanges under certain rules. This should help firms to compete effectively in the international market place.
- 2.20 We have considered alternative approaches to the designation of the CISX and its addition to the designation investment exchanges list. We believe that our proposal is the most appropriate way to meet our statutory objectives as it makes the minimum change necessary to ensure that the guidance gives effect to the intention we are consulting on.

**Contact**

We invite comments on the proposed amendments. Comments should reach us by 19 November 2003. Please send them to:

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# 3 Proposed amendments to the Interim Prudential sourcebook for Insurers

## Introduction

- 3.1 We propose amendments to the *Interim Prudential Sourcebook for Insurers* (IPRU(INS)) to clarify the meaning of two definitions.
- 3.2 These amendments are proposed in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000:
  - section 138 (General rule-making powers);
  - section 150(2) (Actions for damages); and
  - section 156 (General supplementary powers).
- 3.3 These amendments, set out in Annex 3, are relevant for insurers that are part of an insurance group. They are not of direct interest to retail consumers.

## Proposed amendments

- 3.4 We intend to amend the definition of ‘relevant regulatory requirements’ and ‘notional required minimum margin’. These definitions are used to value interests of insurers in insurance undertakings (including pure re-insurers) and insurance holding companies in the Parent Undertaking Solvency Calculation (PUSC).

### *Definition of ‘relevant regulatory requirements’ (Chapter 11)*

- 3.5 The definition of ‘relevant regulatory requirements’ refers to rules that apply to an “insurer” without (in paragraph (b) of the definition) distinguishing between a “direct insurer” and a “re-insurer”. The Insurance Groups Directive (98/78/EC) requires that the rules for a “direct insurer” apply. So, the words “other than a pure re-insurer” would be inserted after the first use of the word “insurer” in paragraph (b) to give effect to what was originally intended.

### *Definition of 'notional required minimum margin' (Chapter 11)*

- 3.6 The definition of 'notional required minimum margin' uses the required minimum margin of a direct insurer for pure re-insurers where pure re-insurers have their head office in a "designated state" or "territory". The UK is not a designated state. So, the words "other than a pure re-insurer" would be inserted after the first use of the word "insurer", in paragraph (c) of the definition, to give effect to what was originally intended. In particular, for the purposes noted in paragraph 4.4 the required minimum margin is calculated as if a pure re-insurer in the UK were carrying on direct insurance business.
- 3.7 We proposed a separate amendment to this definition in CP175 *Miscellaneous amendments to the Handbook (No 7)*. The proposed amendment shown in Annex 3 assumes that we will have made the amendment proposed by CP175 before we make the amendment proposed here.

### **Cost benefit analysis**

- 3.8 The change is proposed primarily to ensure directive compliance.
- 3.9 There is a marginal cost to groups containing pure re-insurers in the UK (and a direct insurer) because a slightly different calculation will need to be done. For each of the 6 or so groups concerned, we believe this will represent an annual cost of less than  $\frac{1}{2}$  a man-day of work or an additional cost of less than £1000 a year for each group<sup>3</sup>.
- 3.10 The change to the 'notional required minimum margin' will result in a PUSC for the 6 groups identified above that will show, on the face of it, a less favourable position. It will increase the notional solvency requirement of pure life reinsurance subsidiaries of up to 300% for the purpose of the group calculation. Nonetheless, the impact on the overall calculation is likely to be limited, unless a group has significant pure life reinsurance subsidiaries.
- 3.11 The calculation is only an information requirement. Where the new calculation results in a material difference, any resulting action taken by the supervisors would take into account the overall financial position of the group including the basis on which the calculation was prepared. It is possible that this might lead to additional costs. But this cannot be realistically quantified, as any extra capital required would be a matter of judgement. No action is likely, as the supervisory assessment of the current calculation is likely to have already considered the presence of pure life reinsurers in the group, and their lower solvency requirement compared to direct insurers. Likewise, this is not

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3 We have assumed a salary of £100k per annum. To arrive at a *per diem* rate, we have assumed an overhead factor of 250% and 225 day working year. On the basis of half-a-day's work, these assumptions result in additional costs of £555  $(= (£100,000/225) \times 0.5 \times 250\%)$ .

new information for analysts, so we do not anticipate any change in the assessment of groups as a result of this new calculation.

- 3.12 The new basis is required to comply with the requirements of the Insurance Groups Directive. Overall we do not expect the change to have any material effect on our treatment of firms, nor do we expect any business adjustments in the industry.

### **Compatibility statement**

- 3.13 The amendments proposed in this consultation paper correct certain parts of the IPRU(INS) sourcebook where the rules and guidance do not reflect the directive requirements imposed by the Insurance Groups Directive.
- 3.14 The compatibility statement in CP50, the original consultation about implementing the Insurance Groups Directive, explained how the relevant parts of IPRU(INS) are compatible with our general duties. We do not think that this change alters the analysis in CP50. In fact, this change has regard to the desirability of maintaining the international competitive position of the United Kingdom. This is because accurate implementation of the Insurance Groups Directive is necessary to ensure that UK insurers have access to the European single market in insurance, which is essential to the maintenance of the competitive position of the UK insurance industry.
- 3.15 The proposals make the minimum amount of change necessary to ensure that the rules are accurate and usable, and are directive compliant. We therefore consider that they are the most appropriate way of meeting our objectives.

#### **Contact**

We invite comments on the proposed amendments. Comments should reach us by 19 November 2003. Please send them to:

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# 4 Proposed amendments to the Supervision manual and the Interim Prudential sourcebook for Banks

## **Introduction**

- 4.1 We propose amendments to the *Supervision manual* (SUP) and to the *Interim Prudential sourcebook for Banks* (IPRU(BANK)) to correct and clarify the guidance on financial reporting requirements in SUP 16 generally and SUP 16 Ann 1R and Ann 2G. Changes are also proposed to Chapters GN, LE and CB in IPRU(BANK) to reduce the requirements on firms.
- 4.2 The amendments are relevant to banks and building societies.
- 4.3 Annex 4 contains the proposed text of the revised rules and guidance.

## **Explanation and details of proposals**

- 4.4 The purpose of the proposed amendments to SUP is to correct omissions and to amend and update the guidance on the financial reports required from banks and building societies.
- 4.5 Several of these amendments are to rectify errors in validations. Others address the impact of the introduction of individual capital ratios and clarify the location in SUP of information on reporting requirements.
- 4.6 Also, we are taking the opportunity to drop the collection of text on some of the financial reports submitted by banks, rather than automate the collection of it.
- 4.7 We are also taking the opportunity to clarify some reporting requirements for banks and building societies. But we do propose one new reporting requirement for banks established outside the EEA to submit annual accounts.
- 4.8 The proposed amendments to IPRU(BANK) would remove the requirement from banks to submit policy statements annually. Because we want the requirement removed before the end of 2003, there is a shorter consultation period on these changes.

## Detail of proposals

### *Form B7*

- 4.9 We propose to cease collecting data on Form B7 which is textual. This affects the breakdowns to items 1.6 and 2.7, and items 11 and 12. We had identified these items as ‘quick wins’ following on from Discussion Paper 12 *The new regulatory reporting environment*. We feel it would be better to introduce these as soon as possible. We will leave the boxes on the returns but will not expect them to be completed from March 2004. As a result, there are some knock-on changes to the definitions and validations for Form B7.

### *Form BSD3*

- 4.10 We propose changes to the Form BSD3 guidance to take account of the introduction of individual capital ratios late in 2001. With the introduction of an individual capital ratio, which replaces the ‘trigger’ ratio, and the demise of the ‘target’ ratio for banks, we have changed the definitions for Sections C and D of Form BSD3. The wording for the items on the forms is also being changed at this time, but no changes are required to the validations.
- 4.11 Two validations for Form BSD3 Section A were omitted from the Handbook text put to the FSA Board in September 2001. We propose to reinstate these validations.
- 4.12 We have identified a conflict between two of the validations for Appendix A-V of Form BSD3. Consequently, we propose to remove validation 4, which is now out of line and conflicts with validation 7 in the same section.
- 4.13 We are aware that some banks have excess collateral for repos/reverse repos, which was not previously catered for in reporting. We have decided to clarify the reporting practice so that such excess collateral shows up in the bank’s reporting. We think only a few firms will be affected by this change. However, the change has no impact on the capital adequacy calculations, although it does require changes to the validations for Appendix B-IV.
- 4.14 The only textual items on the BSD3 are within items A330 and A790.2. We currently process this data manually. As with the B7 items, we identified them as ‘quick wins’ following DP12, and intend to drop these breakdowns from the March 2004 submissions of the report. There are a few consequential changes to the validations following the removal of these items from the Form.

### *Form LR*

- 4.15 The definition of Total Deposits in Form LR was changed in August 1999 (and was set out in SRN/1999/5 at the time). It was stated then that “the Form LR should not include working capital deposits placed by non-resident offices of

the reporting institution”. It continued “the previous definition [i.e. in the previous version of the LR definitions] did not explicitly either include or exclude these sums”. The effect of that change was to make the ‘total deposits’ figures which banks should be reporting there match almost exactly the figure of deposits that were used in the previous liquidity regime calculations.

- 4.16 We have identified that this exclusion was added in error to the end of the items to be included in deposits. We propose to amend this error by updating the reporting instructions for Form LR. We do not view this as a change in our policy, but a clarification of a position already set out for this return. This change is only likely to affect a few of the banks authorised since N2.
- 4.17 Although there are some textual items on Form LR, we do not propose any changes to the form at this time. However, we may revisit this at a later stage.

#### *Form M1*

- 4.18 For Form M1 we have identified a long-standing error in the validation guidance. We propose to correct this error.
- 4.19 There are two textual items (items 80 and 140) on the existing Form M1 that we have decided to remove with effect from March 2004 submissions. We have revised the Form and its definitions to reflect these changes, and removed a validation relating to item 80. These changes should simplify the reporting burden on firms.

#### *All forms*

- 4.20 We propose to insert at the end of each of sections 1, 2, 5, 6 and 7 of SUP 16 Ann 2G the “cell code” versions of the financial returns. These give users an easy way to identify the code allocated to each part of a return, and should facilitate validation. The “cell code” versions of the returns (B7, BSD3, LR, M1 and SLR1), which take account of all the changes proposed here, have not been included in this document but can be viewed on our web site on the page which relates to this CP, at <http://www.fsa.gov.uk/pubs/CP/199/>.

#### *Supervisory Guidance Notes*

- 4.21 The Central Bank and Financial Services Authority of Ireland Act 2003 came into force on 1 May 2003. On that date, the Central Bank of Ireland changed its name to ‘Central Bank and Financial Services Authority of Ireland’. We propose to amend Appendix D of the Supervisory Guidance Notes to reflect that change.
- 4.22 We also propose to delete the list of eligible banks from Appendix G of the Supervisory Guidance Notes. We would then refer users instead to the Bank of England website where this information is available. Changes can be made available more quickly than through the Handbook, as we would otherwise

have to consult on a list which is not produced by us. The change will benefit firms, as the list available on the Bank of England's website will always be their latest version.

- 4.23 We propose to amend Appendix I of the Supervisory Guidance Notes to remove the detail of reporting dates, and to make it clear that these dates can be found in SUP 16.7. The onus will be on firms to calculate their own due dates taking account as necessary of reporting dates, Bank Holidays, and whether the returns are submitted electronically. Although this may seem a retrograde step to banks, it is necessary as each firm has a unique set of reporting dates and submission times for the returns that may result in a fine if submitted late.

#### *Reporting requirements*

- 4.24 So far as submissions under SUP 16.7.13R by banks are concerned, we are conscious that the Bank of England has restricted hours for the receipt of returns (both electronically and by hand), and we are amending SUP 16.7.15R to show these times. Returns submitted to the Bank of England outside these hours are therefore likely to be regarded as received the following business day. For building societies, we are amending SUP 16.7.19R to reflect the revised means of submission of reports that have been in place since N2.
- 4.25 When the Handbook text was put to the Board for making in September 2001, it omitted a requirement that a bank established outside the EEA submit its head office annual accounts to us. This had formerly been accepted practice. Indeed, reviewing the annual accounts helps us to assess whether the threshold conditions for authorisation continue to be satisfied. So, we propose to amend SUP 16.7.12R to include this requirement, with a nine-month submission period. These annual accounts are already prepared by the head offices, albeit in their local language. However, we need to have a version in English so we can interpret the contents, and this will be a cost to firms.

#### *Policy statements*

- 4.26 We believe that requiring banks to submit their policy statements on an annual basis (on 1 January) is too onerous, and is a burden on both firms and us. However, we do want to receive a revised policy statement when a significant change in a bank's policies takes place. We therefore propose dropping the annual submission requirement in Chapter GN of IPRU(BANK), with consequential changes to Chapters LE and CB, and seek greater consistency in the wording. The detailed changes proposed are set out in Annex 4.
- 4.27 To ensure that banks can benefit from this as soon as possible, we have a very short consultation period to 31 October 2003 on these changes only. This is to enable the necessary Handbook Notice and legal instrument to be in place and

effective by 31 December 2003. Because these changes, if effected quickly, will benefit all banks, we believe the shorter consultation period is warranted.

## **Compatibility statement**

### *Compatibility with our regulatory objectives*

- 4.28 The proposed amendments to SUP 16 in Annex 4 are minor in nature and, because they improve the accuracy and usability of the corrected provisions, they enhance the compatibility of those provisions with our statutory duties. Similarly, the proposed amendments to IPRU(BANK) in Annex 4 are minor in nature and are compatible with our general duties. The proposals are also compatible with our regulatory objectives under the Act as set out below.
- 4.29 *Market confidence.* The proposed amendments to SUP and IPRU(BANK) will help us meet this objective by assisting banks and building societies in providing us with accurate information. Access to appropriate information is a key contributor to our understanding of markets and achieving the market confidence objective. The reduction in the data items collected do not impinge on this, as they were at a very detailed level and the broad detail will still be provided. We will still have an interest in the policy statements produced by firms. However, instead of the regular provision of the statements even if they were unchanged, they will form part of our risk assessment of each firm. The formal provision of annual accounts by certain banks will also help us to assess the financial strength of these firms as part of our review of the threshold conditions.
- 4.30 *Public awareness.* The proposed amendments do not have implications for this objective.
- 4.31 *Consumer protection.* The proposed amendments impact on this objective in the same way as the market confidence objective through the provision of better and more accurate detail.
- 4.32 *Reduction of financial crime.* The proposed amendments do not have implications for this objective.

### *Compatibility with the principles of good regulation*

- 4.33 The proposed amendments to SUP 16 and IPRU(BANK) are minor in nature and compatible with the matters which we must have regard to in fulfilling our general functions for the same reasons as the Supervision manual as a whole. In particular, the following specific points are relevant.
- 4.34 *The need to use the FSA's resources in the most economic and efficient way.* The proposed amendments will remove the need for us to duplicate public lists issued by the Bank of England, for example by removing the need to

consult on factual changes to the List of Eligible Banks published by the Bank of England. It also removes the need for us to replicate material on reporting requirements that appears elsewhere in SUP. Reducing the need for textual data on some forms will enable us to operate more efficiently and effectively in processing the data, while losing little in the interpretation of the data.

- 4.35 *The responsibilities of those who manage the affairs of authorised persons.* The proposals clarify the reporting requirements, assisting those responsible for managing banks to understand their responsibilities, for instance in relation to reporting schedules.
- 4.36 *Proportionality.* The reduction in textual reporting requirements is a small and relatively simple way of trying to balance more adequately the burden and restrictions on firms with the benefits to consumers. In some cases, we may require similar information occasionally as part of our risk assessment of a firm.
- 4.37 We believe that the costs to firms of implementing these changes will be minor. In many cases, the costs will be an indistinguishable part of the annual costs of software support. However, for those firms that maintain their own IT systems and software, the costs will be higher but still small.
- 4.38 We do not believe that the proposals impinge on the other principles of good regulation.
- 4.39 We therefore believe that our proposals are the most appropriate way of meeting our regulatory objectives.

### **Cost benefit analysis**

- 4.40 These proposed changes should benefit firms by simplifying, clarifying and correcting some of the reporting requirements while removing the more labour-intensive textual items from the regular reports. Dropping annual policy statements is a simple step in that direction. Unless there are significant changes to the policy in the interim, when we should be consulted, they will only be requested when required for a risk assessment exercise. Also, removing lists published by third parties from our guidance will reduce the need for consultation should the lists change. Removing the textual detail from the returns will also save on reporting costs, although equivalent data may be required at the time of a risk assessment.
- 4.41 For us, the quality and consistency of the data should be maintained, if not improved, and be more efficiently collected and analysed. The formal receipt of annual accounts from banks established outside the EEA in English will allow us better to assess the financial well-being of the bank and its head office and puts on a formal footing a pre-existing arrangement. Reducing the need to prepare and consult on lists is also a more efficient use of our resources.

- 4.42 Overall these proposed changes will not, we believe, lead to increased costs for firms of more than minimal significance. We do not believe that any of the changes require significant changes to IT systems. Most of the minor changes to definitions and validations will form part of the normal IT overheads for firms, in most cases as part of the annual charges by software providers. However, for those firms which are responsible for their own financial reporting packages, there may be some extra costs, but we believe these will be minor. The translation of the annual report and audited accounts into English is a cost that is already being incurred by these firms, albeit not on a formal basis at present.
- 4.43 On that basis, we do not believe the changes require a cost benefit analysis in line with section 155(8) of the Act and our commitment to undertake cost benefit analysis of material changes in regulatory requirements.

### Contact

We invite comments on the proposed amendments. Comments should reach us by:

- 31 October for the changes described in paragraphs 4.26 and 4.27; and
- 19 November 2003 in respect of the other changes.

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# 5 Proposed amendments to the Conduct of Business sourcebook and the Glossary

## Introduction

- 5.1 We are proposing amendments to the *Conduct of Business sourcebook* (COB) and to the *Glossary*. We would make these amendments under sections 138, 139(4), 145, 147, 149, 156 and 157(1) of the Financial Services and Markets Act 2000 (FSMA).
- 5.2 The text of the amendments proposed in this chapter is in Annex 6 below. They affect the following provisions:
- COB 5 (advising and selling) – COB 5.2.9R and COB 5.2.5R;
  - Glossary definition – pension transfer.
- 5.3 The amendment to COB 5.2.9R is likely to be of particular interest to consumers or consumer groups.

## COB 5.2.9R and COB 5.2.5R

- 5.4 The proposed amendments are relevant to product providers and IFAs. They are also likely to be of interest to consumers as they concern the records firms are required to make of a customer's personal and financial circumstances. The proposed changes restore the pre-N2 position on the retention of records and clarify our requirements of firms.
- 5.5 Under the previous regulatory requirements (in the PIA rules) firms did not need to keep a record of a customer's personal and financial circumstances unless a purchase or disposal of an investment resulted from the advice given. This position was not, as intended, fully reflected in the COB rules. The effect of this is that the rules as they stand require firms to retain all records regardless of whether or not a sale proceeds.
- 5.6 A number of firms have raised this rule with us, arguing that the additional post-N2 requirement to retain records where a sale does not proceed is unduly

onerous. We agree and do not believe that any consumer detriment will result from the removal of this requirement.

- 5.7 Under our complaints rules (DISP 2.4.8R) a consumer has the right to complain, in his capacity as a potential customer, to a firm and to the Financial Ombudsman Service (FOS) about the firm's actions or failure to act. Whilst the likelihood of complaints from potential customers is generally low, firms may consider it prudent to retain all records, even where a sale does not proceed, to be able to deal with any such complaint that may arise. However, we believe that this is essentially a commercial matter for individual firms to decide. Firms will, in any case, tend to keep records for an initial period before concluding that there will in fact be no sale. (We do not propose to define what this period should be.)
- 5.8 As the proposed change is a relaxation compared with the requirements as they now stand, we do not propose any transitional provision.
- 5.9 The proposed amendment to COB 5.2.9R is in Annex 5. We have also made a minor amendment to COB 5.2.5R to ensure that it is consistent with the changes we propose to make to COB 5.2.9R.

### **Cost benefit analysis**

- 5.10 This change would mean that firms would not have to retain records where their recommendation does not lead to a sale or their services were not taken up. The proposed amendment would reduce costs for firms compared with the position if the change is not made and would not adversely affect our consumer protection objective.

### **Amendment to the Glossary definition of Pension Transfer**

- 5.11 We propose to change the "pension transfer" definition as currently defined in the *Glossary*. When we consulted in CP156 on pension transfer reporting requirements it became apparent that the current definition does not specify that transfers to pension buy-out contracts are included. This was contrary to our policy intention.
- 5.12 We believe that firms undertaking pension transfer business will in fact have interpreted this defined term as including pension buy-out contracts (and will therefore have applied the same detailed transfer value analysis requirements and checking procedures to these contracts). However, we now propose to rectify this oversight. This will remove any uncertainty and ensure consistency across all firms engaged in this type of business and it will also ensure that all pension buy-out contracts are included in firms' quarterly and half yearly returns (COB 5.3.26R). Firms will also be clear that our Training and Competence and our Conduct of Business rules will apply.

- 5.13 As we believe that firms are, in any case, already interpreting the definition in this way, we do not consider that any significant systems or other changes for firms will be necessary. We therefore do not believe that any transitional arrangements are necessary and would propose to bring this change into force with effect from 1 January 2004.

### **Cost benefit analysis**

- 5.14 We believe that the costs arising from this change will be minimal. We believe that firms giving advice on a pension transfer are applying our Training and Competence requirements and Conduct of Business rules and will already be taking into consideration pension buy-outs when advising customers on the options available to them. The software currently available to firms will already cater for this level of analysis and the calculations associated with it. We believe, therefore, that this proposed definitional change would impose no additional costs on firms.

### **Compatibility statement**

- 5.15 This statement applies to all the COB amendments described above. These proposals make minor corrections to certain parts of the COB sourcebook where the rules and guidance do not reflect our intention when we originally consulted in CP45, CP57 and CP90. The corrections merely give effect to our original intentions. The compatibility statements in those CPs explain how the relevant parts of the COB regime are compatible with the objectives and how in framing them we have had regard to the principles of good regulation. Those compatibility statements were based on our intention rather than on the precise wording of the draft rules and guidance that appeared in the CPs. Those intentions are unchanged and the proposed changes simply enhance COB's compatibility with the objectives and the principles, as outlined in the previous CPs.

### **Most appropriate way of meeting the objectives**

- 5.16 The proposals make the minimum changes necessary to ensure that the rules and guidance give effect to the intentions on which we are consulting. So, we consider that they are the most appropriate way of meeting our objectives.

## Contact

We invite comments on the proposed amendments. Comments should reach us by 19 November 2003. Please send them to:

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# 6 Proposed amendments to the Money Laundering sourcebook and consequential changes

## Introduction

- 6.1 We are proposing amendments to the *Money Laundering sourcebook* (ML) and consequential changes to other parts of the Handbook.
- 6.2 These proposals will be of only minor interest to consumers. Consumers should benefit, however, to the extent that changing legal and regulatory obligations on relevant firms yield better protection for those firms against criminal activity, whether through fraud or money laundering. But they may have little interest in the detail of the changes.

## Background

- 6.3 The Money Laundering sourcebook requires relevant firms to have effective anti-money laundering systems and controls in place to reduce the opportunities for laundering of criminal funds through those firms. In imposing these regulatory obligations, the sourcebook must keep pace with, and reflect, the changing requirements of the criminal law, whether through Acts of Parliament or regulations.
- 6.4 The *Money Laundering sourcebook*, which came into effect on 1 December 2001, reflected the UK's anti-money laundering regime at that time. However, several legislative changes have taken place since then which mean the sourcebook now needs amending.
- 6.5 First, an objective test of 'reasonable grounds' for knowledge or suspicion in relation to money laundering offences was introduced, with certain safeguards, in the Proceeds of Crime Act 2002. This meant that a person working in the regulated sector who failed to report his knowledge or suspicion of handling criminal funds could not simply claim that he neither knew nor suspected any criminal connection. In essence, he would have committed an offence if it could be proved, in court, that a reasonable man, faced with the same facts, would have been suspicious and have made a report

to the appropriate authorities. Therefore, we amended the internal and external reporting requirements in the sourcebook to include the objective test of ‘reasonable grounds for knowing or suspecting’.

- 6.6 Second, it was necessary to amend various identification rules to reflect particular provisions in the Money Laundering Regulations 2001, which introduced a registration system for money service businesses (bureaux de change, cheque cashers and money remitters) with HM Customs and Excise. Both sets of amendments to the sourcebook came into effect on 1 December 2002.
- 6.7 Since then, HM Treasury has developed revised regulations (the Money Laundering Regulations 2003), which will, we understand, for the most part, come into effect on 1 January 2004. The 2003 Regulations will amend the Money Laundering Regulations 1993 and 2001 to:
- implement the requirements of the second EU Money Laundering Directive in the UK, by including new professions and activities within the regulated sector; and
  - consolidate, clarify and update provisions in the 1993 Money Laundering Regulations, with some substantive changes where problems have arisen.
- 6.8 The principal effect of the Directive is to widen the range of businesses within the regulated sector that are required to comply with the anti-money laundering systems and controls obligations currently in the 1993 Regulations. The regulated sector will now include:
- auditors;
  - external accountants and tax advisers;
  - real estate agents;
  - notaries and other legal professionals acting for clients in any financial or real estate transactions; dealers in high-value goods who wish to accept cash payments of the equivalent of 15,000 or more; and
  - casinos.

### **Proposed Amendments**

- 6.9 The changes we wish to make, and are now consulting on, are set out in Annex 6 and are described below

#### *Definitions in the Glossary*

- 6.10 It is necessary to update the definition of the ‘Money Laundering Regulations’ and to delete ‘Money Laundering Regulations 2001’. We propose also to extend the definition of ‘money laundering’ to include all the offences listed in section 340(11) of the Proceeds of Crime Act 2002, for the sake of consistency with regulation 2(1) of the Money Laundering Regulations 2003.

*Status of guidance (ML 1.2.4G)*

- 6.11 To make clear that the sourcebook does not constitute relevant guidance under the criminal law, we propose to update the cross reference to the Money Laundering Regulations and also to insert a reference to the relevant provision in the Proceeds of Crime Act 2002.

*Assessing firms' compliance with the sourcebook (ML 1.2.5G and ML 3.1.4G)*

- 6.12 We propose to widen the scope of ML 3.1.4G, which presently cross-refers only to the guidance on identifying clients in the Joint Money Laundering Steering Group's Guidance Notes for the Financial Sector. We now wish to make clear that, in assessing a firm's compliance with the sourcebook, we will have regard to those Guidance Notes wherever they directly apply to particular provisions within the sourcebook. This will make the sourcebook consistent with the *Enforcement manual* (ENF 11.9.1), which has the same broad effect. In the circumstances, we consider it appropriate to delete ML 3.1.4G and move the revised guidance to the 'Purpose' chapter of the sourcebook, as ML 1.2.5G.

*The duty to identify and the exceptions (ML 3.1.3R, ML 3.2.1R, ML 3.2.2R, ML 3.2.4R, ML 3.2.5R, ML 3.2.6G)*

- 6.13 It is necessary to update the cross-reference in ML 3.1.3R 2(A) to the provision in the Money Laundering Regulations 2003 dealing with the registered number of a money service operator.
- 6.14 However, the 2003 Regulations will have their most significant impact on section 3.2 of the sourcebook. This section deals with exemptions from the duty to identify the client and what constitutes sufficient evidence of identity.
- 6.15 First, the Regulations will substantially widen the list of exemptions from the duty to identify the client. In broad terms, the list comprises:
- credit and financial institutions based in the UK or another EEA state; and
  - entities undertaking comparable activities to those of a credit or financial institution (except money service operators).
- 6.16 Therefore, the list includes, for example, lawyers and accountants providing specified kinds of financial services to their clients. So, we propose to widen the exemptions in ML 3.2.2R(1) to include authorised professional firms, who carry out a number of both regulated and Annex activities. We also propose to widen the exemptions to cover regulated entities based in jurisdictions whose law contains comparable provisions to those in the Money Laundering Directive.

- 6.17 Second, it is also necessary to amend the exemption in ML 3.2.2R(3), which deals with introduced one-off transactions, to align it with the equivalent provisions in the 2003 Regulations. We do not consider it appropriate to extend the current safeguard in sub-paragraph (a) – namely, that the introducer of the client is covered by the Money Laundering Directive – to the full range of new entities brought within the scope of the second Directive and now the 2003 Regulations. So, we propose to restrict the range of eligible introducers by specifying that the introducer be a credit or financial institution, an authorised professional firm, or an entity undertaking comparable activities in an EEA state.
- 6.18 Third, ML 3.2.4R, which has until now matched the so-called ‘postal concession’ in 1993 Regulation 8, needs to be deleted. This is because the provision has been removed from the 2003 Regulations by HM Treasury. It was removed on the grounds that firms were free to decide for themselves whether particular types of business were sufficiently low risk for money laundering purposes to justify personal identity verification based solely on payment from an account at an EEA credit institution.
- 6.19 Fourth, as regards ML 3.2.5R, which concerns business undertaken by a client on behalf of a third party in circumstances not covered by ML 3.2.2R (1) or (3), we propose to replicate the wording of the 2003 Regulations. So we specify only that reasonable steps be taken by the firm accepting the business. In view of the sourcebook’s wider read-across to the Joint Money Laundering Steering Group’s Guidance Notes (see paragraph 6.12 above), we consider it preferable for the Guidance Notes to set out in the necessary detail what measures would be appropriate in particular circumstances. Such measures critically depend on where the introducer and third party are located and on whether either is a regulated entity.
- 6.20 The result of redrafting ML 3.2.5R in this way is that ML 3.2.6G becomes redundant and can be deleted.

*Internal and external reporting (ML 4.1.1G, ML 4.1.2R, ML 4.1.3G, ML 4.1.4R, ML 4.3.2R, ML 6.2.1R)*

- 6.21 Part 7 of the Proceeds of Crime Act 2002 created a single set of money laundering offences applicable throughout the UK to the proceeds of all crimes. One consequence of that updating, expansion and unification of existing money laundering offences has been to prompt a potentially vast increase in the number of reportable fraud-related offences, where the perpetrator of the fraud is unknown. This would arise, for example, where a credit card is stolen and the thief makes as many purchases as possible with the card before it is reported stolen and then cancelled by the card issuer. In such cases, each fraudulent use of the card would be reportable by the card issuer but, if disclosed to the National Criminal Intelligence Service (NCIS) on

every occasion, would result in a mass of reports containing little or no intelligence value.

- 6.22 Accordingly, the Director General of NCIS has used his powers under Part 7 of the Act to appoint an officer within certain firms to receive such fraud-related reports and not pass them to the firm's Money Laundering Reporting Officer or to NCIS itself every time. In the circumstances, we propose to amend ML 4.1.1G, ML 4.1.2R(1), ML 4.1.3G, ML 4.3.2R(1) and ML 6.2.1R(2) to add appropriate references to the NCIS-appointed person. We also propose, during the consultation period, to discuss with firms how the arrangements actually work in practice.
- 6.23 In addition, we have reconsidered the wording of ML 4.1.2R, which currently restricts the internal reporting requirement to knowledge or suspicion that a client, or someone for whom the client acts, is engaged in money laundering. This differs from the external reporting requirement in ML 4.3.2R(2), which refers to reporting that 'a person' has been engaged in money laundering. We believe that in the light of the Proceeds of Crime Act reporting requirements referred to above, and for reasons of consistency, it would be appropriate to adopt the latter wording to align the internal and external reporting obligations. So, we propose to amend ML 4.1.2R.
- 6.24 We have proposed a new rule, ML 4.1.4R, which closely reflects regulation 7(3) of the 2003 Regulations. This states that the obligation to make an internal report does not apply where the organisation is a professional legal adviser and the knowledge or suspicion of money laundering is based on information that came to it in privileged circumstances.
- 6.25 With regard to external reporting, we have proposed a new rule, ML 4.3.2R(2), which would oblige a firm's Money Laundering Reporting Officer to have regard to any new legal requirement prescribing the form and manner of making a disclosure to NCIS.

*Information about material deficiencies (ML 5.1.4G)*

- 6.26 We propose to make clear that firms can find the most up to date information about material deficiencies in the anti-money laundering regimes of other countries directly from the Joint Money Laundering Steering Group's website. It is, however, also possible to access this information via our website.

*Minor technical amendments (ML 7.1.4G, ML 7.1.11R, ML 7.3.2R)*

- 6.27 These are all minor technical changes:
- the term 'appropriate person' is no longer used in the 2003 Money Laundering Regulations, which now refer to the 'nominated officer' as the

person responsible for handling internal and external reporting under the Regulations;

- the amendment to ML 7.1.11R(3) is necessary to correct an error; and
- the provisions in ML 7.3.2R that relate to record keeping for clients who become insolvent have been removed from the 2003 Regulations.

### *Consequential amendments to other parts of the Handbook*

- 6.28 First, it is necessary to amend the reference to the Money Laundering sourcebook in APER 4.7.9E, to correct an error.
- 6.29 Second, the reference to the Money Laundering sourcebook in SYSC 3.2.7G has been misinterpreted as meaning that the sourcebook is an exhaustive statement of our requirements in relation to money laundering. This was not our intention. So we propose to make clear that the sourcebook must be read with other FSA requirements and with the criminal law.
- 6.30 Third, in CRED it is necessary to remove the reference to ML 3.2.4R (see paragraph 6.18 above). This entails a considerable shortening and redrafting of CRED 12.3.6G. At the same time, we are taking the opportunity to clarify and update other passages of guidance to credit unions, in CRED 12.4.1G and CRED 12.5.1G.

## **Cost benefit analysis and compatibility statement**

### *Cost benefit analysis*

- 6.31 The changes to the Money Laundering sourcebook, and other minor and consequential amendments, proposed in this consultation paper will result in a cost increase of no more than minimal significance. For this reason, we consider that there is no need to complete a detailed cost benefit analysis.
- 6.32 This is because firms should already comply with changes in the criminal law that are in force. The amendments to the rules are intended to make the sourcebook consistent with changes introduced in the Money Laundering Regulations 2003 and the Proceeds of Crime Act 2002. On the assumption that firms do comply with the criminal law, there should be no, or only minimal, additional compliance costs. Where we have taken the opportunity to clarify particular provisions in the sourcebook, or to correct errors, there should be no cost and an overall benefit to firms. For example, we have reconsidered the scope of ML 3.1.4G (see paragraph 6.12) and now wish to make clear that we will have regard to the Joint Money Laundering Steering Group's Guidance Notes wherever they are directly applicable to the sourcebook. This entails no cost to firms and should yield some overall benefit.

- 6.33 The changes explained in paragraphs 6.21 and 6.22 reflect administrative procedures already in place to ensure that the NCIS does not receive a mass of fraud-related reports of little or no intelligence value. Our proposed amendment of the sourcebook will serve to reduce firms' reporting requirements, and so their overall costs.
- 6.34 The change explained in paragraph 6.23 might appear to impose significant additional costs on firms through widening the internal suspicion reporting requirement to cover "a person" rather than simply "a client or someone for whom the client acts". However, we believe that this will not be the case and that, if additional costs do arise, they will be of only minimal significance. This is because, in practice, firms will have trained their staff in the recognition and reporting of any suspicious transactions, irrespective of who the person under suspicion might be.
- 6.35 However, in one particular area – namely, that of exceptions to the duty to identify the client (see paragraphs 6.15 to 6.19) – we have had to interpret the policy intention behind the relevant provisions in the Money Laundering Regulations 2003. The Regulations contain certain specific inclusions and exclusions but there is a grey area in between with no clear boundary line. The necessary detail of application of the Regulations will, in due course, be made clear in the 2003 edition of the Joint Money Laundering Steering Group's Guidance Notes, which are subject to approval by the Treasury-chaired Money Laundering Advisory Committee in line with section 330(8) of the Proceeds of Crime Act 2002. So we will ensure that the eventual final amendments to ML 3.2 match the application of the Regulations, to avoid imposing any unnecessary costs on firms by having to comply with differing legal and regulatory obligations.

#### *Compatibility statement*

- 6.36 This statement explains why we believe that these proposed amendments are compatible with our general duties under section 2 of the Financial Services and Markets Act 2000 (FSMA).
- 6.37 FSMA sets out four regulatory objectives. One of these objectives is the reduction of financial crime.
- 6.38 In January 2000, we published "A new regulator for the new millennium". In it, we set out our overall approach to all four objectives, highlighting the money laundering element in the financial crime objective. Then, in April 2000, we published CP46 *Money Laundering – the FSA's new role* and, in January 2001 a Policy Statement in response to the earlier consultation paper. Subsequently we undertook some minor amendments to our *Money Laundering sourcebook*, reflecting changes in the criminal law, which came

into force on 1 December 2002. The proposals set out in this chapter are a further development of the approach set out in those documents.

- 6.39 The proposed amendments ensure that our Money Laundering Rules reflect the requirements of the anti-money laundering regime approved by Parliament. They also aim to ensure that our rules and guidance are clear, up-to-date and consistent with the law, to help us meet our objectives. The proposals make the minimum amount of change necessary for that purpose and so we see them as the most appropriate way to meet our statutory objectives. For example, paragraph 6.33 explains how reporting requirements would have increased if we had chosen the option of not changing the Handbook text. This shows that we have proposed the solution that brings benefits to firms at no additional cost.

#### *Principles of good regulation*

- 6.40 In line with the requirement in section 2(3) of FSMA, in framing these proposals, we have kept in mind the following principles.
- 6.41 *The need to use our resources in the most efficient and economic way.* In developing these proposals, we have used our resources efficiently and economically. We have done this, at no cost to the FSA, by mirroring the criminal law, rather than imposing new obligations, and by using the opportunity to make other desirable changes that should minimise the need for future amendments to the rules.
- 6.42 *The responsibilities of those who manage the affairs of authorised persons.* The rules relate to systems and controls and themselves impose no requirements directly on senior executive managers. The proposals in this chapter give greater detail on money laundering, but do not alter the rules for senior management arrangements, systems and controls.
- 6.43 *The principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from that burden or restriction.* We are satisfied that burdens and restrictions imposed by the proposed rules are proportionate to the expected benefits (see paragraphs 6.31 to 6.35). We are not materially adding to burdens already imposed on firms by law.
- 6.44 *The desirability of facilitating innovation in connection with regulated activities.* In framing the proposed rules, we have sought not to impede innovation. Any net benefit highlighted in the cost benefit analysis will, in principle, allow firms to devote more resources to innovation.

- 6.45 *The international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom.* We have kept in mind our international and EU obligations in drafting the rules. The rules will further assist UK firms to operate effective anti-money laundering systems and controls. This should serve to ensure that the UK remains one of the most effective international financial centres in combating money laundering, thereby making the UK attractive to firms concerned to protect themselves from reputational risk.
- 6.46 *The need to minimise the adverse effects on competition that may arise from anything done in the discharge of those functions.* So far as is practical, the rules apply common requirements across all regulated firms and activities. Our proposed amendments, which impose costs of no more than minimal significance, do not materially affect competition.
- 6.47 *The desirability of facilitating competition between those who are subject to any form of regulation by the Authority.* In drawing up these proposals, we have kept in mind the desirability of facilitating competition between regulated persons. However, the effectiveness of anti-money laundering systems and controls is not an area in which firms compete with each other, given the common legal framework and shared public policy objectives.

### **Preventing financial crime**

- 6.48 Additionally, in considering whether the proposed amendments fulfil the financial crime objective, we have kept in mind the desirability of the following principles, as set out in section 6(2) of FSMA.
- 6.49 *Regulated persons being aware of the risks of their businesses being used in connection with the commission of financial crime.* The proposed rules draw attention to recent substantive changes in the criminal law that widen the scope of the anti-money laundering systems and controls obligations and strengthen the suspicious activity reporting obligations on staff of firms in the regulated sector. This will highlight the importance of the current rules on awareness and training, of all staff who handle, or are managerially responsible for the handling of, transactions or activity more generally that may involve money laundering.
- 6.50 *Regulated persons taking appropriate measures (in relation to their administration and employment practices, the conduct of transactions by them and otherwise) to prevent financial crime, facilitate its detection and monitor its incidence.* The alignment of the *Money Laundering sourcebook* with recently introduced criminal law measures is likely to enhance the deterrence and detection of financial crime.

6.51 *Regulated persons devoting adequate resources to the matters mentioned above.* The *Money Laundering sourcebook* already contains provisions that awareness training must be carried out for staff and that the MLRO must have enough seniority and resources to do his job. This is made even more important by the matters described above.

### Contact

We invite comments on the proposed amendments. Comments should reach us by 18 December 2003. Please send them to:

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# 7 Proposed amendments to the Collective Investment Schemes sourcebook, the Conduct of Business sourcebook and the Glossary

## **Introduction**

- 7.1 We are proposing amendments to the *Collective Investment Schemes sourcebook* (CIS). These would require the financial statements contained in the annual and half-yearly reports of authorised CISs to comply with the new Statement of Recommended Practice (SORP), which we expect the Investment Management Association (IMA) to bring into effect on 1 December 2003.
- 7.2 There would be a consequential amendment to the *Conduct of Business sourcebook* (COB) and a new definition for the *Glossary*.
- 7.3 The changes will be of particular interest to operators of CISs. The IMA SORP will result in changes to the information provided to consumers in annual and half-yearly reports, so the proposals in this CP may also be of interest to consumers and consumer groups.
- 7.4 We propose to make these amendments under sections 138, 156, 157 and 247 of the Financial Services and Markets Act 2000 (FSMA) and regulation 6 of the Open Ended Investment Company Regulations 2001.
- 7.5 The proposed amendments are shown in Annex 7.

## **New Statement of Recommended Practice**

- 7.6 The proposed new requirements are intended to replace the current requirements for compliance with the SORP for authorised unit trusts (issued by IMRO in 1997) and the SORP for authorised open-ended investment companies (issued by us in 2000).

- 7.7 The provisions in the SORPs are relevant to our consumer protection and market confidence objectives but they are mainly concerned with accounting principles for CISs. Following approval by the Accounting Standards Board in December 2002, the IMA is now responsible for setting the SORPs themselves. The decision for the FSA to take, following the present consultation, is whether to specify the new version of the SORP as the relevant standard which it requires firms to follow.
- 7.8 In May this year, following a review of the two existing SORPs, the IMA consulted on proposals for the new SORP to apply to accounting periods commencing on or after 1 December 2003. The main purpose of the IMA consultation was to seek views on a combined and updated set of recommendations for the preparation of financial statements for unitholders in all authorised funds. The IMA consultation ended on 18 August. We are informed by the IMA that, subject to approval by the Accounting Standards Board, they propose formally to issue the new SORP (text available at [www.investmentuk.org/imasorp.htm](http://www.investmentuk.org/imasorp.htm)) in November.
- 7.9 Based on the date on which we expect the SORP to be effective, our proposed rules would require compliance with the IMA SORP for CISs with half-yearly or annual accounting periods commencing on or after 1 December 2003. However, we propose introducing a transitional rule so that CISs with half-yearly or annual accounting periods commencing before 1 December 2003 will be able to choose between the IMA SORP and the relevant existing IMRO or FSA SORP. We expect to make our rules in early 2004 for the proposed changes to come into effect on 1 February 2004.
- 7.10 Whilst some of the relevant accounting periods may start before the proposed rules will come into effect (on 1 February), the obligation on firms to produce half-yearly and annual reports using the IMA SORP will only arise after the relevant accounting period has ended. So, the first reports that will need to comply with the IMA SORP will be for half-yearly accounting periods ended on 1 June 2004. Given this and the period in any event permitted under our rules for publication and availability of annual and half-yearly reports, we think operators will have enough notice to enable them to implement the accounting changes necessary to prepare accounts in compliance with the new IMA SORP.

### **Proposed amendments to CIS 10, Glossary and COB**

- 7.11 We propose to replace the current references to the SORP for AUTs and/or ICVCs with references to the IMA SORP. The CIS provisions amended are CIS 10.1.4G, CIS 10.3.3R(1), CIS10.3.4.R(1), CIS 10.3.6R(3), CIS 10.4.8R(1), and CIS 10.4.9R(2).

- 7.12 There is a consequential amendment to COB 6.6.65G, which we propose will refer to the IMA SORP.
- 7.13 We also propose to define ‘IMA SORP’ in the *Glossary*. The definition we propose refers to a specific edition of the IMA’s SORP. If the SORP is amended in future, we may update the *Glossary* definition without consultation, if the changes made have no material adverse implications for our regulatory objectives or for the validity of the cost benefit analysis included in the CP.

### **Cost benefit analysis**

- 7.14 We consider that, reflecting the adjustments the IMA proposes to make to the new SORP, the proposed changes to our rules will give rise to costs of no more than minimal significance. In its consultation on the SORP, IMA said it did not expect there to be additional costs either for firms or consumers. IMA also posed specific questions about the extent to which certain aspects would increase compliance costs. No respondent to the consultation disagreed with IMA’s view on costs.

### **Compatibility statement**

- 7.15 Our proposals, which are chiefly aimed at our consumer protection and market confidence objectives, will continue to require the financial statements of authorised funds to be prepared to a high standard. The change of responsibility for issuing SORPs reflects both our view that the SORP, though relevant to our regulatory objectives, is primarily concerned with accounting principles and our duty under FSMA to use our resources in the most efficient and economic way. Apart from enabling us to use our resources in a more efficient and economic way, the proposals have no implications for the principles of good regulation to which section 2(3) requires us to have regard.

### **Most appropriate way of meeting the objectives**

- 7.16 The proposals make the minimum changes necessary to ensure that the rules and guidance give effect to the intentions on which we are consulting. So, we consider that they are the most appropriate way of meeting our objectives.

## Contact

We invite comments on the proposed amendments. Comments should reach us by 19 November 2003. Please send them to:

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# 8 Proposed amendments to the Decision making manual

## Introduction

- 8.1 This chapter proposes amendments to Appendix 1 (Settlement procedure and mediation scheme for FSA disciplinary cases) of the *Decision making manual* (DEC). These amendments reflect our commitment to continue to offer mediation as part of our decision making process following the review of our pilot mediation scheme. We hope that, by increasing the flexibility of the scope and timing of mediation in the decision making process, mediation will contribute to the faster delivery of enforcement outcomes.
- 8.2 The purpose of the proposed amendments is to clarify when settlement discussions and mediation are available to firms or individuals subject to our decision making process. The proposed amendments also extend the availability of our mediation scheme, in certain circumstances, to some categories of disciplinary cases that were excluded from the pilot scheme. We would make these amendments under section 157 of the Financial Services and Markets Act 2000 (FSMA).
- 8.3 The text of the proposed amendments is set out in Annex 8. This includes a consequential amendment for the *Enforcement manual* (ENF).

## Background

- 8.4 As a result of the original public consultation on our new decision making procedures under FSMA, we developed a pilot mediation scheme that came into effect, along with our other decision making procedures, in December 2001. The purpose of the pilot scheme was to provide a facility for a neutral mediator to assist us and the firms and individuals subject to our decision making process to reach agreement where settlement discussions had failed. The objective of the scheme was to enhance the decision making process by allowing for the quick and cost effective resolution of enforcement cases.

- 8.5 The pilot scheme was originally to run for a period of 12 months, although this was extended for a further 9 months, until the end of August 2003. In our original proposals, we made a commitment to monitor and review the operation of the scheme. In line with Paragraph 1.12.1 of Appendix 1 to DEC, we published anonymous information on the operation of the scheme in our Annual Report earlier this year. To monitor the operation of the scheme, our appointed mediation provider has conducted detailed debriefs with both parties following each mediation. We have also conducted a wide-ranging review of the scheme framework, obtaining feedback from firms that have taken part in FSA mediations and their legal advisers, our mediation provider, our case teams and the Chairman of the Regulatory Decisions Committee (RDC).
- 8.6 The purpose of our review has been to examine whether the pilot mediation scheme has operated as an effective (including cost-effective) and valuable element of our decision making process. In addition to evaluating the benefits provided by the scheme, we have sought to identify any aspects of the scheme that might be changed to improve its effectiveness as a settlement tool. We regard the review and the proposals for amending the framework of the scheme as an important contribution to our strategic aim of establishing an appropriate, proportionate and effective regulatory regime in which consumers, firms and other stakeholders have confidence.
- 8.7 The findings of our review of the scheme and the amendments that we propose making as a result of the review are set out below.

### **Findings of the review of the pilot mediation scheme**

- 8.8 Of those cases brought before the RDC falling within the scope of the pilot scheme, 76% entered into informal settlement discussions with us. 17% of eligible cases went on to use the mediation scheme. All of those cases that elected to mediate reached an agreed settlement at the mediation that was subsequently approved by the RDC.
- 8.9 Whilst these statistics indicate that relatively few RDC cases have gone to mediation to date, the success rate of the scheme has been high. We have also agreed to mediate, in exceptional circumstances, a case falling outside the RDC process. Our experience in this case was that, whilst resolution was not achieved at the mediation, the case settled shortly afterwards as a result of progress made at the mediation.
- 8.10 Our review indicates that the cost of using the scheme for each party has been between £2,000 and £7,000. This cost includes the cost of the mediator preparing for and attending the mediation and the administrative costs of the mediation – it does not include the time and resource costs of the parties taking part in the mediation (for example, management time costs and the cost of legal representation). The costs of using the scheme reflect the fact that

the mediations that have taken place to date have all involved complex regulatory issues that have, in some instances, resulted in the mediation being conducted over the course of two days. We would hope that less complex cases might be mediated at lower costs and are considering the possibility of flexible fee structures.

8.11 Feedback received as a result of our review indicates that firms and their legal advisers, our enforcement case teams, and the RDC have found the mediation scheme to provide a valuable addition to the decision making process. More specifically, feedback indicates that one of the benefits of mediation has been to enable a better understanding of each party's prioritisation of the issues in dispute. Our review indicates that these issues include:

- the severity of the sanction;
- the wording of the final notice;
- the timing of the publication of the final notice; and
- the corrective/remedial action to be taken by the firm or individual concerned.

8.12 All of the cases that have settled at mediation have resulted in a mutually agreeable resolution of all of these issues; this settlement has then been approved by the RDC. On the basis of this feedback and the statistics on the numbers of eligible RDC cases going to mediation, we believe that there is a strong case for retaining the scheme as part of our decision making process.

8.13 Having considered feedback received on the issues of availability and scope of the mediation scheme, we have concluded that there are compelling arguments for making amendments to the current framework of the scheme in these areas. The proposed amendments in these two areas are set out in detail below. During the public consultation on the proposed amendments, the current pilot scheme will remain in place until the new scheme, incorporating any proposed amendments that are made by our Board, comes into effect.

8.14 To date, we have not publicised the fact that specific cases have settled as a result of the mediation scheme. In light of the positive impact that we believe mediation has on the enforcement process, we will be looking in the future to make public the use of mediation to achieve settlement in specific cases. We believe that this is an important part of encouraging regulated entities to consider the potential benefits of settlement and mediation.

### **Proposed amendments**

8.15 The text of the amendments proposed in this chapter (see Annex 8 below) affects the following paragraphs of Appendix 1 of DEC:

- 1.1.1G (Introduction);

- 1.2.1G (Settlement);
- 1.3.3G (Mediation);
- 1.4.1G, 1.4.2G and 1.4.3G (Scope of mediation scheme);
- 1.6.1G (Starting the mediation);
- 1.7.11G (Costs); and
- 1.12.1G (Review of mediation procedures).

### **Changes relating to the scope of the scheme**

- 8.16 Under the pilot mediation scheme, mediation has been available in enforcement cases involving disciplinary matters and market abuse, with the following exceptions:
- (1) cases involving allegations of criminal offences;
  - (2) cases involving allegations of unfitness or impropriety based on judgements about dishonesty or lack of integrity;
  - (3) cases involving the exercise of our own-initiative powers on a variation of permission; and
  - (4) cases involving disciplinary action for late submission of a report as referred to in ENF 13.5.
- 8.17 In light of our policy to apply the principles in the Code of Crown Prosecutors when considering whether to bring a criminal prosecution, we continue to believe that it would not be appropriate to mediate in cases involving criminal allegations. We also believe that the time and costs required to mediate would be disproportionate to the likely penalties in cases involving disciplinary action for late submission of reports.
- 8.18 In the course of our review, we have received feedback from mediation providers and some firms that non-criminal cases involving issues of dishonesty and lack of integrity might be successfully mediated, but other stakeholders did not agree. Feedback also suggests that mediation may be of assistance in the decision making process following the exercise of our own-initiative powers on a variation of permission, for example, in reaching agreement on the timing and remit of steps to be taken by the firm or individual concerned following the initial variation of permission. However, most stakeholders agreed that the availability of mediation in these cases should not compromise the need to act quickly and that, for this reason, mediation should not be available until after the first supervisory notice has been issued.

- 8.19 We have considered the following options in relation to the scope of the scheme:
- (1) the scope of the mediation scheme to remain unchanged;
  - (2) the mediation scheme to be available in all types of enforcement cases providing we consent;
  - (3) the mediation scheme would not be available in cases where we are contemplating bringing a criminal prosecution but would be available in all other enforcement cases; or
  - (4) the mediation scheme would not be available in cases where we are contemplating bringing a criminal prosecution but would be available in all other enforcement cases. However, the mediation scheme would only be available in cases involving allegations of dishonesty or lack of integrity and own initiative variations of permission, where we consent.
- 8.20 On the basis of the feedback received during the course of our review, we are proposing to amend the scheme to reflect the fourth of these options. We believe that this proposal provides the maximum benefit to firms and individuals subject to our decision making process whilst minimising the risk that the efficiency of that process will be compromised by unsuccessful mediations.

### **Changes relating to the availability of settlement and mediation**

- 8.21 Currently, the Introduction to Appendix 1 of DEC states that settlement discussions take place on an informal basis after we have given a warning notice. Whilst there is no bar on settlement discussions at an earlier stage, Appendix 1 provides that such discussions are likely to be less productive until after we have issued the warning notice.
- 8.22 The pilot mediation scheme also states that mediation will be available to those persons against whom action is proposed after settlement discussions have broken down. The framework of the mediation scheme states that the period after the warning notice is the natural point for informal settlement discussions and that these discussions may be supplemented by mediation. The framework does not restrict the availability of mediation at any point in the decision making process.
- 8.23 Feedback obtained during the course of our review from our case teams indicates that settlement discussions may be beneficial before the issue of the warning notice, providing that the RDC is sufficiently appraised of the issues in dispute. Depending on the particular circumstances of the case, firms or individuals may wish to enter into settlement discussions early on in the enforcement process. Settlement discussions before the warning notice may help the parties to reach an agreed solution at a very early stage of the

decision making process, thereby saving on the costs and resources required to defend regulatory proceedings. Experience shows that settlements can and do occur at this stage of the process and we are therefore proposing to amend the settlement procedure to encourage early settlement discussions in appropriate circumstances.

- 8.24 We have received feedback from firms, their legal advisers and our case teams that the requirement for settlement discussions to have “broken down” before mediation becomes available does not contribute to the effectiveness of the scheme. It may often be difficult to ascertain whether negotiations have broken down. In those cases where it is clear that they have broken down, the parties may have become so polarised as a result of the break down of the settlement discussions that reaching a satisfactory outcome at the mediation may be more difficult. There may be instances in which an early election to mediate can help to maintain a dialogue between the parties and increase the likelihood of a successful mediation.
- 8.25 It also appears, from feedback from firms that have used the scheme and our case teams, that the most productive time for mediation to take place is between the issue of the warning notice and the decision notice. Mediations that follow the representations stage may be particularly effective as, by this stage, both parties will have articulated those issues that they believe to be central to their case. However, whilst mediation may be most beneficial between the warning and decision notice stage, this is not the only time at which mediation can contribute to the enforcement process. Feedback also indicates that mediation can (and has) occurred successfully after the issue of a decision notice, in particular, with respect to any remedial steps that may be agreed between the parties.
- 8.26 We have considered the following options in relation to the timing of settlement and mediation in the decision making process:
- (1) the timing of settlement and mediation in the enforcement process to remain as it was during the pilot period;
  - (2) settlement and mediation to be available at any time during the decision making processes; or
  - (3) settlement to be available at any time during the enforcement process. We will mediate in all appropriate enforcement cases following the issue of the warning or first supervisory notice and prior to the issue of the decision notice or second supervisory notice. Mediation will be available, providing we consent, at any other time in the decision making process.
- 8.27 On the basis of the feedback received during the course of our review, we are proposing to amend the scheme to reflect the third of these options. We believe that this proposal provides the maximum benefit to firms and individuals

subject to our decision making process whilst minimising the risk that the efficiency of that process will be compromised by unsuccessful mediations.

## **Cost benefit analysis**

### **Benefits**

- 8.28 By removing the requirement for settlement negotiations to have broken down before mediation is available, we have sought to increase the flexibility of the scheme and to accelerate the resolution of enforcement cases. By extending the availability of the scheme in appropriate circumstances before the issue of the warning notice, we hope that there will be greater savings of time and cost from earlier settlement in those cases that might otherwise have settled at a later stage of the decision making process.
- 8.29 By limiting the availability of mediation before the warning notice and after the decision notice stage, we intend to offer mediation only in those cases where there is a genuine prospect of reaching an agreed settlement. We believe that this approach will enhance the efficiency of the decision making process, allowing us to use our resources in the most efficient and effective way and achieve our statutory objectives (for example, by obtaining timely redress for consumers or preserving the integrity of the market). We also believe that this approach will avoid both parties wasting time and resources in circumstances where mediation is unlikely to achieve a positive outcome.
- 8.30 The benefits of successfully mediating cases previously excluded from the scheme (cases involving allegations of dishonesty or lack of integrity and own-initiative variations of permission) will include saving time and resources that might otherwise be spent completing the various stages of the RDC process. For example, there will be savings in time and resources if these cases settle before the representations stage. A successful mediation will also save any time and resource costs that may have been spent making a reference to the Financial Services and Markets Tribunal. Mediation may also result in more pragmatic solutions to the regulatory issues that arise in these cases. Such solutions, in the context of own initiative variations of permission, may focus on the limitations, restrictions or requirements placed on a firm's permissions or the timing and effect of any action that the firm must take in the wake of the variation of permission. In the context of those cases involving allegations of dishonesty and lack of integrity, such solutions may focus around issues of compensation and redress. These solutions may reduce the costs to firms of disruption to their operations and will also reduce the costs to consumers of delayed compensation.
- 8.31 Reaching an agreed solution through the process of mediation in these cases may also be of benefit to the ongoing relationship between firms and individuals and us. This is because mediation assists the parties to understand

the issues in dispute and the objectives that have resulted in regulatory action. A resolution of these issues may result in a reduction in the likelihood of firms and individuals failing to meet regulatory requirements in the future. This in turn will result in a reduction of the costs to firms, individuals and us associated with such regulatory breaches. A reduction in failures to meet regulatory requirements will also benefit consumers and the market as a whole.

- 8.32 These proposals would limit the availability of mediation in cases based on dishonesty or lack of integrity or own-initiative variations of permission by requiring consent. By doing this we hope to minimise the risk that mediation (in those cases where it is unlikely to lead to an agreed settlement) may compromise the efficiency of the decision making process.

### **Compliance costs to firms and to the FSA**

- 8.33 As mediation is an option rather than a requirement of the decision making process, the proposed changes to the scope of the scheme will not necessarily have an impact on the cost of regulatory proceedings. However, in those cases involving allegations of dishonesty or lack of integrity or own-initiative variations of permission where both the firm/individual concerned and we agree to mediate, there will be cost implications for both parties. As set out in paragraph 8.10 above, the costs of using the scheme in those cases that have mediated have been between £2,000 and £7,000 (depending on the length of the mediation and the complexity of the particular case).
- 8.34 In addition to these costs, the parties will also incur the cost of management time in preparing for and attending the mediation and legal representation (although legal representation is not a requirement for the process). It is difficult to estimate these costs as they will depend to a significant degree on the length of the mediation, the complexity of the case and also whether the parties choose to be legally represented.
- 8.35 Any decision to mediate in these cases involve a cost benefit analysis on the part of both parties, with the cost of the mediation being weighed against the benefits of achieving an agreed settlement in the particular case. We believe that the costs of the mediation, including the overall saving of costs as a result of reaching early settlement, will be outweighed by the benefits.
- 8.36 We do not believe that the proposed amendments relating to the timing of the mediation scheme will impose any additional costs on firms or individuals.

### **Conclusion**

- 8.37 The findings of our review indicate that in all mediations that have taken place to date, the perceived benefits (both from the FSA's perspective and the perspective of the firms/individuals concerned) have outweighed the cost of undergoing the process. We would hope that, in those cases that may mediate

as a result of the proposed changes to the scope of the scheme, a similar outcome would be achieved.

### **Compatibility statement**

- 8.38 The purpose of the proposed amendments to our settlement procedure and mediation framework is to enhance the efficiency and effectiveness of our decision making process. An efficient and effective decision making process will help us to achieve our statutory objectives of maintaining confidence in the financial system, protecting consumers and reducing financial crime. The proposals have no significant impact on our public awareness statutory objective.
- 8.39 We also believe that the proposed amendments are compatible with the principles of good regulation. In particular, the proposed changes are designed to promote the efficient and economic use of our resources and the principle that a burden or restriction which is imposed on a person should be proportionate to the benefits which are expected to result from the imposition of that burden.

### **Most appropriate way of meeting the regulatory objectives**

- 8.40 Our review of the mediation scheme highlighted two areas in which the effectiveness of the scheme might be enhanced. We have considered a number of possible options for amending the timing and scope of the scheme (see paragraphs 8.19 and 8.26 above) and we believe that the options that we are proposing are the most appropriate way of meeting our regulatory objectives.
- 8.41 By including enforcement cases previously excluded from the scheme and making mediation available prior to the issue of the warning notice, we are maximising the benefits that mediation brings to the decision making process. By requiring that mediation in these circumstances (and following the issue of a decision notice) be by our consent, we would also minimise the risk to firms of the cost of unsuccessful mediations and the compromise of our decision making process.

Q1: Do you agree with the proposals to extend the scheme to cases involving issues of dishonesty or lack of integrity and own-initiative variations of permission, provided that the FSA consents?

Q2: Do you agree with the proposals to remove the requirement that settlement discussions must have broken down before an election to mediate can be made?

Q3: Do you agree with the proposals that mediation should be available before the warning notice and after the decision notice with the consent of the FSA?

Q4: Do you have any other comments to make in relation to the framework of the mediation scheme?

### Contact

We invite comments on the proposed amendments. Comments should reach us by 19 November 2003. Please send them to:

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# 9 Proposed amendments to the Complaints sourcebook and the Compensation sourcebook

## Introduction

- 9.1 This chapter proposes amendments to the *Complaints sourcebook* (DISP) and the *Compensation sourcebook* (COMP). These proposals would change the process for firms wishing to notify us that they do not deal with *eligible complainants* or *eligible claimants* and so are eligible to claim exemption from certain of the requirements placed upon firms under DISP and COMP. These requirements relate principally to the funding of the Financial Ombudsman Service and the Financial Services Compensation Scheme.
- 9.2 These changes would be made under sections 138, 156, 157, 213, 214 and 226 of the Financial Services and Markets Act 2000.

## Changes to the process of exemption notification (DISP 1.1.7R and COMP 13.3.1R)

- 9.3 We propose changing the current system, which requires annual re-notification by firms, to one where exemptions remain valid indefinitely, or until a firm notifies us that it no longer meets the criteria for exemption. This will help to reduce the regulatory burden on firms and reduce costs both for firms and for us. This measure should have no direct effect on consumers
- 9.4 Accordingly, these changes are likely to be of interest to firms, but of limited interest to consumers.
- 9.5 We propose that these amendments should take effect from 1 February 2004.
- 9.6 The text of the proposed amendments described in this Chapter is set out in Annex 9.

## **Cost benefit analysis**

- 9.7 These amendments modify the arrangements for the notification of exemption under the criteria in DISP and COMP, but do not give rise to any increase in costs. Since the amendments also create no detriment for consumers, they do not require a cost-benefit analysis, in line with section 155(8) of FSMA.

## **Compatibility with our regulatory objectives**

- 9.8 We believe that the proposals will have no material impact on any of our four objectives and are irrelevant to five of our seven principles of good regulation to which we must have regard. However, the proposal should, at the margin, reduce compliance costs and direct costs and are therefore both proportionate and in keeping with the need for us to use our resources in the most efficient and economic way. We therefore believe that the proposals are the most appropriate way of meeting our regulatory objectives.

### **Contact**

We invite comments on the proposed amendments. Comments should reach us by 19 November 2003. Please send them to:

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# 10 Proposed amendments to the Supervision manual and the Credit Unions sourcebook

## **Introduction**

- 10.1 This chapter proposes amendments to the *Supervision manual* (SUP) and the *Credit Unions sourcebook* (CRED). The new Handbook material includes rules, guidance on rules, and guidance on the exercise of other FSA functions. We would make these amendments under sections 138, 156 and 157 of the Financial Services and Markets Act 2000 (FSMA).
- 10.2 The text of the proposed amendments described in this Chapter is set out in Annex 10.

## **Supervision manual**

### **Credit union supervisory return**

- 10.3 We propose a number of minor amendments to the credit union annual return and guidance note in SUP 16 Ann 14(2)R and SUP 16 Ann 15(2)G. We would require the auditor to express an opinion as to whether or not the information in the credit union's supervisory return is consistent with its published accounts (rather than whether or not it has been completely and accurately extracted from those accounts). The amended statement would more closely reflect the expected relationship between the accounts and the return, and is therefore more appropriate for the auditor to sign. The other amendments make minor corrections and clarify what information is required in various parts of the return.

### **Cost benefit analysis**

- 10.4 The amendments to the return and guidance note do not require extra information or extra work by the auditor, so no additional costs are imposed. Indeed, by making the returns clearer, and so easier to complete, we expect there could be very modest savings in volunteers' time.

## **Credit Unions sourcebook**

### **Loans to credit union officers**

- 10.5 We propose to make a rule to ensure that where credit unions make loans to officers, this is done on the same terms as to other members (CRED 10.2.7AR – see also CRED 10.2.7G). Lending to officers is quite normal in credit unions, where there is a regular turnover of officers: these are mostly existing members, who joined the credit union in the first place so that they could obtain credit, and who volunteered, or have been elected, to serve a term in a particular office. The amendment does not discourage loans to officers, but aims to prevent the abuse of their being offered on more favourable terms (typically at a lower interest rate). This practice is generally considered improper, but is not illegal (as it is for building societies, which are also mutual deposit-takers). We understand from our discussions with trade associations that the practice is sometimes discovered at credit unions that have failed, and we have also come across it in the course of our normal supervision. Our new rule will make good the absence of a statutory restriction.

### **Cost benefit analysis**

#### *Costs*

- 10.6 The incidence of covert “soft” loans to officers is sporadic, and there is no quantitative data for the number of such loans or the effective subsidy involved, so we have been unable to estimate the theoretical cost to officers of losing access to such covert subsidies in future. Moreover, our rule will not affect any existing loans.

#### *Benefits*

- 10.7 In strictly financial terms, the absence of subsidies on loans to officers also represents an equal saving to the credit unions concerned, and so, indirectly, to their other members. But the more important benefit is the improvement in the transparency and integrity of credit unions’ management: ordinary members will have greater assurance that the officers are not being covertly favoured at their expense.

### **Systemic risk from intra-sector loans**

- 10.8 We propose to provide guidance that loans between credit unions should only be arranged after both parties have carefully considered the financial implications (CRED 7.2.7G). Seasonal patterns of demand for loans and share withdrawals (particularly ahead of Christmas and summer holidays) are common to all credit unions, and the purpose of the amendment is to advise credit unions against systematically tying up funds with other credit unions on

any major scale. This is not intended to discourage the provision of temporary assistance by one individual credit union to another, as long as this is prudent. We also propose a rule to make clear that loans between credit unions do not count as liquidity for the lender (CRED 9.3.7R(2)). This will avoid the same funds being used to support liquidity in two different credit unions at the same time.

## **Cost benefit analysis**

### *Costs*

- 10.9 There is no aggregate data for the amount of loans made by one credit union to another during the course of any one year, but at the end of 2001 the total of such loans outstanding was almost £400,000. Nor do we know what proportion of the amount was needed as prudential liquidity (to satisfy CRED 9) by the lender. However, if we make the cautious assumption that as much as half that amount was counted for that purpose, that gives a figure of £200,000 for the amount that may have to be redeployed or refinanced at greater cost (i.e. the lender moves the funds to another deposit-taker, and earns less, and the borrower raises the extra money from other sources, and pays more). There is no collected data covering the interest rates charged between credit unions: we expect these will be close to commercial rates, but with a slight cost advantage to either side (otherwise this practice would be intrinsically unattractive). So we make the working assumption that the extra cost (of lower interest earned by the lender, and higher interest paid by the borrower) is one quarter per cent to each party: that produces in one year an additional cost of £500 on each side, a combined cost for the credit union movement of £1,000.

### *Benefits*

- 10.10 Our proposed rule and guidance will help to reduce systemic risk among credit unions – that is, the risk that (say) a seasonal cash flow problem initially affecting one, or a few, CUs could spread across the sector because of the extent to which CUs have invested their liquid funds with each other and then find that these cannot be repaid just when they are needed. Reducing this systemic risk helps to ensure that every credit union can meet its members' requirements for loans and share withdrawals on a timely basis.

## **Loan periods**

- 10.11 We propose that credit unions with the mortgage lending permission (but only those credit unions) will be able to make regulated mortgage loans (but not other kinds of loans) for up to 25 years. Other kinds of loans will remain subject to CRED's shorter time-limits (which originally derived from the

Credit Unions Act). (See the amendments to CRED 10.3.1R, CRED 10.3.3R and 10.3.6R.) This will allow credit unions that obtain the mortgage lending permission to take proper advantage of it, without increasing credit risks generally by relaxing the limits for other types of loans. We intend that this should take effect on 31 October 2004, the date for the commencement of mortgage regulation.

### **Cost benefit analysis**

- 10.12 The longer period will apply to credit unions that choose to take out the new mortgage lending permission: the rule change is permissive and does not impose additional costs.

### **Protection of “credit union” name**

- 10.13 As the Treasury has brought into force, in amended form, section 3 of the Credit Unions Act 1979, it will be an offence from 1 September 2003 for most entities (other than credit unions themselves) to use the words “credit union” (in a name or in describing themselves) unless this has our approval. A major impact of this change will be on “study groups” – the voluntary associations preparing for registration/authorisation as a credit union. We propose to incorporate guidance into CRED on the new legal provisions (CRED 13.2A.1G – CRED 13.2A.2G ), with a reminder that the general prohibition in section 19 of FSMA means that study groups cannot accept deposits (CRED 13.2A.4G). This will bring the legal requirements to the attention of affected entities. The guidance also sets out our policy that approval for study groups to use the words “credit union” will generally be limited to two years (CRED 13.2A.3G). We think this should generally be enough time to complete the process of obtaining registration. If after two years the study group wants more time, we will have the opportunity of considering whether use of the name remains appropriate.

### **Cost benefit analysis**

- 10.14 Any costs (including the possibility of statutory fines) arising from the name protection provisions in section 3 of the Credit Unions Act 1979 are attributable to that legislation, not to our guidance, which in itself involves no additional costs. By helping study groups understand how to comply with section 3 we will minimise the risk that they will be fined for non-compliance.

### **Higher liquidity and operational risk of providing money transmission services**

- 10.15 The Treasury’s recent deregulation order facilitated credit unions for the first time providing and charging for a range of ancillary services to their members (involving, potentially, cheque books, debit cards and other money

transmission). A credit union taking up these opportunities will expose itself to higher liquidity and operational risk, as the members' savings become more mobile. We propose to provide guidance (in CRED 4.3.68G and CRED 9.2.9G) to draw the attention of credit unions to the need to mitigate this risk. This will help them relate the risk from these new activities to the existing rules and guidance on liquidity and risk management to which credit unions are already subject.

### **Cost benefit analysis**

- 10.16 The amendment we are proposing does not introduce any new obligations, but merely provides guidance to assist credit unions in complying fully with existing rules and guidance in new circumstances. It is for credit unions to decide whether or not to provide any particular ancillary service, and to assess what additional risks this may entail, and then decide what form and level of risk mitigation would be appropriate for their circumstances. It is not possible for us to estimate what costs, if any, this possible risk mitigation might carry, but in any case they are attributable to the underlying, existing requirements. The guidance in itself involves no additional costs.

### **Acceptance of deposits**

- 10.17 As a result of a Treasury transitional Order before NCU, credit unions may now borrow legally from any source. The intention of the Order was to liberalise borrowing, not to undermine the common bond concept by allowing credit unions to accept deposits from individual non-members. We propose to make rules (CRED 7.3.1R – CRED 7.3.2G, CRED 7A.3.1R – CRED 7A.3.2G) that reinforce (for the avoidance of doubt), and preserve, the position that deposits may only be accepted from individuals who are members (and share a common bond). The common bond is one of the defining characteristics of credit unions, and these rules will ensure that a possible loophole is plugged.
- 10.18 We also propose that the limit on an individual juvenile deposit should be the greater of £5,000 and 1.5 per cent of the total shareholdings in the credit union. This will put juvenile deposits on the same footing as members' shares, following the abolition (by the same Treasury Order) of the requirement in the Credit Unions Act that juvenile deposits should be held on trust and maintained in a separate fund.

### **Cost benefit analysis**

- 10.19 Credit unions have not tried to exploit the possible loophole of accepting deposits under the guise of borrowing from individual non-members outside the common bond, so the proposed rule will not in practice impose additional

costs on them. The increase in the limit for juvenile deposits is purely permissive and does not involve additional costs.

### **Reiteration of existing policy and additional clarifications**

- 10.20 We propose to provide guidance that reiterates policy and makes clearer a number of other issues governed by statute, to remove some common misunderstandings among credit unions:
- (1) the objects of credit unions are restricted by the Credit Unions Act 1979, and credit unions entering into new ventures need to satisfy themselves that they have the necessary power (the guidance – in CRED 13.4.1G – makes it clear that credit unions do not have the power, for instance, to run lotteries);
  - (2) only individuals may be members of a credit union and receive loans under the Credit Unions Act, so disguised lending to corporate bodies via the aggregation of loans to individuals is not permissible (CRED 10.2.11G(2));
  - (3) a credit union may not acquire property vastly in excess of its operating requirements to let it out (guidance in CRED 7.2.8G on the effect of section 12 of the Credit Unions Act 1979);
  - (4) some explanation in CRED 7A.3.2G(4) and (5) about the abolition (by Treasury transitional Order) of the requirement in the Credit Unions Act that juvenile deposits should be maintained in a separate fund;
  - (5) clarifications in CRED 13 Ann1G about credit union membership qualifications and the common bond;
  - (6) clarification in CRED 13 Ann2G on whether and how grandchildren would qualify indirectly as juvenile depositors; and
  - (7) highlighting in CRED 14.10.13(G) why credit unions do not have to produce an annual report on controllers and close links.

### **Cost benefit analysis**

- 10.21 The new guidance explains parts of the Credit Unions Act 1979 (as amended by subsequent Orders), reinforces existing guidance on best practice and makes various clarifications. It is intended to improve compliance with existing requirements and involves no extra cost to credit unions. It may produce savings (for example, highlighting that juvenile deposits no longer need to be maintained in a separate fund, and helping credit unions to avoid the costs of having to unwind ultra vires transactions).

## Compatibility statement

- 10.22 We are satisfied that the additional rules and guidance we are intending to make or give are compatible with our regulatory objectives, and indirectly help to protect consumers who are credit union members. As for the principles of good regulation, we believe that the proposals take account of the need to use our resources in the most economic and efficient way, by helping to eliminate queries and misunderstandings. They take account of the responsibilities of those who manage the affairs of credit unions (providing guidance, but leaving management free to manage), and are proportionate. They make the minimum amount of change necessary to ensure that the rules and guidance give effect to our policy intentions. So we consider that the proposals are the most appropriate way of meeting our regulatory objectives.

### Contact

We invite comments on the proposed amendments. Comments should reach us by 19 November 2003. Please send them to:

Jonathan Ellis  
Prudential Standards Division  
Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London  
E14 5HS

Telephone 020 7066 0358  
Fax: 020 7066 0359  
Email: CP199@fsa.gov.uk

# 11 Creation of a new sourcebook – the Client Assets sourcebook – and proposed consequential amendments

## Introduction

11.1 As mentioned in the Handbook Development Newsletter in August 2003, we are proposing to introduce a new sourcebook – the *Client Assets sourcebook* (CASS). This will bring together in one sourcebook the existing client assets rules from the *Conduct of Business sourcebook* (COB chapter 9), and the proposed client money rules from the *Insurance and Mortgage Conduct of Business sourcebooks* (ICOB and MCOB). CASS will stand alongside COB, MCOB and ICOB as a distinct sourcebook within the Business Standards section of the Handbook.

## Creation of CASS

11.2 The introduction of the new sourcebook will proceed in three steps:

- creation of the new sourcebook and transfer of COB Chapter 9 to CASS;
- making of client money rules in CASS for insurance mediation activity, coming into force on 15 January 2005; and
- making of client money rules in CASS for mortgage mediation activity (depending on outcome of consultation).

11.3 In this CP we are consulting on a number of technical application provisions, which will facilitate the making of the client money rules for insurance mediation activity. Feedback on the insurance mediation rules will be published in September and it is planned that the rules will be made in December 2003. Feedback on the mortgage mediation rules will be published in the final quarter of 2003.

11.4 Except as explained below, we are not making any changes to the substance of the client assets rules: they will just be renumbered. To assist firms to locate

current rules in the new sourcebook, we will publish Destination and Derivation tables between COB 9 and CASS, and there will be automatic links on the electronic version of the Handbook from COB 9 to the relevant sections of CASS.

- 11.5 In this miscellaneous CP we are consulting on various application provisions, and Schedules 1 to 6 of CASS. There is a new application section in CASS 1 and, because of the structure of chapters within the sourcebook, we are also consulting on a number of additional application provisions for the main part of the sourcebook.

### **Proposed amendment to COB**

- 11.6 We propose one substantive amendment. We have taken this opportunity to correct an error in the existing application section of the COB. Currently COB 1.2.1R(2) disapplies the client assets rules for service companies. Service companies are not allowed to hold client assets, but if they were to act outside their permissions, we would want CASS to apply, to provide appropriate consumer protection of client assets held. By removing the current disapplication, we will restore the original pre-N2 position.

### **Transitional provisions**

- 11.7 We are also consulting on two transitional provisions for CASS as follows:
- to preserve the application of the original transitional provisions in COB to the provisions which are moved to CASS; and
  - a transitional provision allowing for references to COB 9 to be taken as references to CASS 2, CASS 3 and CASS 4. This transitional provision will be in force for one year. This should be particularly helpful for auditors, and will mean that one set of references can be used in audit reports produced over the coming year.

Q5: Do you agree that these are the appropriate transitional arrangements?

- 11.8 We are also consulting on consequential amendments to the Handbook.

#### *CASS 1 – Application*

- 11.9 This contains new material repeating the relevant application sections from COB. These rules are the subject of this consultation.

#### *CASS 2 – Custody*

- 11.10 This chapter is a renumbered copy of COB 9.1 (Custody).

### *CASS 3 – Collateral*

11.11 This chapter is a renumbered copy of COB 9.4 (Collateral).

### *CASS 4 – Client money and mandates: designated investment business*

11.12 This chapter is a renumbered copy of COB 9.2 (Mandates), COB 9.3 (Client money) and COB 9.5 (Client money distribution).

### *CASS 5 – Client money and mandates: insurance mediation activity*

11.13 The proposed client money rules for insurance mediation will be made in this chapter.

### *CASS 6 – Client money: mortgage mediation activity*

11.14 If the proposed client money rules for mortgage mediation are made, they will be in this chapter.

11.15 The proposed changes, described above, are set out in Annex 11.

## **Cost benefit analysis**

11.16 The proposed creation of CASS will not impose any additional obligations on firms, and we believe the cost to firms due to rule renumbering will be negligible, particularly with the lengthy transitional proposed. Furthermore, the proposals will have no effect on consumers or us. With the proposed introduction of client money conduct of business regulation for mortgage and insurance intermediaries, the co-location of COB, ICOB and MCOB client asset rules has the following advantage:

- Easier navigation – firms will have only one place to look for client money and other client assets rules. Placing the rules in one sourcebook should reduce the time spent by firms navigating the rules reducing compliance costs. This should be of particular benefit to those firms engaged in both designated investment business and mediation activity.

11.17 Although there has been a change in the application to service companies, we believe this will have minimal impact as service companies are not permitted to hold client assets, and we are not aware of any service company acting outside its permission. Therefore, we believe there will be no increase in costs for service companies.

## **Compatibility statement**

11.18 This statement applies to all the CASS proposals detailed above. Aside from the restoration of the pre-N2 position for service companies, the creation of CASS does not change current regulatory requirements. We believe that the

proposals will have no material impact on any of the four objectives and are irrelevant to six of the seven principles of good regulation to which we must have regard. The proposals should, at the margin, reduce compliance costs and therefore are proportionate.

- 11.19 With regard to the change for service companies, the compatibility statements in CP45 and CP57 explain how the client asset rules are compatible with the objectives and how in framing them we have had regard to the principles of good regulation. Those compatibility statements were based on our intention and those intentions are unchanged. So, we consider that the change for service companies is compatible with the objectives.

### **Most appropriate way of meeting the objectives**

- 11.20 We consider the introduction of CASS to be the simplest way to facilitate the navigation of the rules. So, we consider that the proposals are the most appropriate way of meeting our objectives. The change for service companies is the minimum necessary to reinstate our original policy intention.

#### **Contact**

We invite comments on the proposed amendments. Comments should reach us by 19 November 2003. Please send them to:

Colleen Glendale-Perry  
Conduct of Business Standards Division  
Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London  
E14 5HS

Telephone 020 7066 5412  
Fax: 020 7066 5413  
Email: CP199@fsa.gov.uk

# 12 Proposed amendments to the Listing Rules

## **Introduction**

- 12.1 In July 2003 a new Code on Corporate Governance (New Code) was published. The New Code supersedes and replaces the Combined Code issued by the Hampel Committee on Corporate Governance in June 1998 (1998 Code). It derives from a review of the role and effectiveness of non-executive directors by Mr Derek Higgs and a review of audit committees by a group led by Sir Robert Smith.
- 12.2 As a consequence of the New Code being published, we are proposing to replace the 1998 Code that is appended to the Listing Rules with the New Code and to make consequential rule changes. These amendments would be made under section 74(4) together with section 101 of the Financial Services and Markets Act 2000 (FSMA).

## **Proposed amendments to the Listing Rules**

- 12.3 The proposed amendments to the Listing Rules are described below and set out in Annex 12.

## **Definition of Combined Code**

- 12.4 We propose an amendment to the definition of the Combined Code to ensure that it reflects the code of corporate governance in force in respect of the relevant annual reporting period for a company. Depending on the period being reported on, the applicable code of corporate governance will be the 1998 Code or the New Code.

## **Requirements of Auditors – LR12.43A**

- 12.5 In the context of the New Code it has been suggested that it would be more appropriate for auditors to sign off on the process undertaken by companies to produce their comply or explain statement rather than to sign off on individual provisions of the Code. We understand that the APB is considering the approach to be taken. We will make the necessary adjustments to the

Listing Rules once the position is clarified. Any further proposed amendments to the Listing Rules will be consulted on in due course.

## **Appendix**

- 12.6 We propose to replace the 1998 Code that is appended to the Listing Rules with the new Code to update the Listing Rules. The appendix does not form part of the Listing Rules.

### **Cost benefit analysis**

- 12.7 The proposed changes will not give rise to costs of more than minimal significance so we are not publishing a CBA.

### **Compatibility statement**

#### **Compatibility with UKLA's HM Treasury agreed objectives**

- 12.8 In presenting these proposals we have considered our objectives, in our capacity as the UK competent authority for listing, as agreed with HM Treasury. Our proposals are consistent with our objectives to provide an appropriate level of protection for investors in listed securities and to seek to maintain the integrity and competitiveness of UK markets for listed securities.

#### **Compatibility with general functions conferred on the competent authority for listing under Part VI of FSMA, including the responsibility for implementing relevant EU Directives**

- 12.9 In presenting the proposals in this CP we are satisfied that they are compatible with our general duties under section 73(1) of FSMA.

### **Contact**

We invite comments on the proposed amendments. Comments should reach us by 19 November 2003. Please send them to:

Belinda Burton  
UK Listing Authority Division  
Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London  
E14 5HS

Telephone 020 7066 8212  
Fax: 020 7066 8213  
Email: CP199@fsa.gov.uk



## Annex 1

### List of specific consultation questions

Chapter	Question	
<b>8. Proposed amendments to DEC</b>	Q1	Do you agree with the proposals to extend the scheme to cases involving issues of dishonesty or lack of integrity and own-initiative variations of permission, provided that the FSA consents?
	Q2	Do you agree with the proposals to remove the requirement that settlement discussions must have broken down before an election to mediate can be made?
	Q3	Do you agree with the proposals that mediation should be available before the warning notice and after the decision notice with the consent of the FSA?
	Q4	Do you have any other comments to make in relation to the framework of the mediation scheme?
<b>11. Creation of a new sourcebook - CASS – and proposed consequential amendments</b>	Q5	Do you agree that these are the appropriate transitional arrangements?



## Annex 2

### Proposed amendment to the Glossary

The amendment shown below is explained in Chapter 2. Underlining indicates new text.

<i>designated investment exchange</i>	any of the following investment exchanges: American Stock Exchange Australian Stock Exchange Bolsa Mexicana de Valores Bourse de Montreal Inc <u>Channel Islands Stock Exchange</u> Chicago Board of Trade Chicago Board Options Exchange Chicago Stock Exchange Coffee, Sugar and Cocoa Exchange, Inc Euronext Amsterdam Commodities Market Hong Kong Exchanges and Clearing Limited International Securities Market Association Johannesburg Stock Exchange Kansas City Board of Trade Korea Stock Exchange MidAmerica Commodity Exchange Minneapolis Grain Exchange New York Cotton Exchange New York Futures Exchange New York Stock Exchange New Zealand Stock Exchange Osaka Securities Exchange Pacific Exchange Philadelphia Stock Exchange Singapore Exchange South African Futures Exchange Tokyo International Financial Futures Exchange Tokyo Stock Exchange Toronto Stock Exchange
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## Annex 3

### Proposed amendments to the Interim Prudential sourcebook for Insurers (IPRU(INS))

The amendments shown below are explained in Chapter 3.

In this Annex, underlining indicates new text.

#### Chapter 11 DEFINITIONS

<i>notional required minimum margin</i>	<p>(a) in the case of an <i>insurance undertaking</i> (other than a <i>pure reinsurer</i>) that has its head office in a <i>designated state or territory</i>, the amount of the <i>required minimum margin</i>, or the equivalent requirement, under the regulatory requirements of that state or territory;</p> <p>(b) in the case of a <i>pure reinsurer</i> that has its head office in a <i>designated state or territory</i>, the amount that would be the <i>required minimum margin</i>, or the equivalent requirement under the regulatory requirements of that state or territory, if the regulatory requirements of that state or territory applicable to undertakings carrying on <i>direct insurance business</i> were applied to the <i>pure reinsurer</i> (whether they are or not); and</p> <p>(c) in all other cases, the amount of the <i>required minimum margin</i> that would apply if the <i>insurance undertaking</i> were an <i>insurer</i> (<u>other than a <i>pure reinsurer</i></u>), with its head office in the United Kingdom (whether it is or not)</p>
<i>relevant regulatory requirements</i>	<p>(a) in the case of a <i>group undertaking</i> that is an <i>insurance undertaking</i>, <i>ultimate insurance parent undertaking</i> or <i>ultimate EEA insurance parent undertaking</i> established in a <i>designated state or territory</i>, at the option of the <i>insurer</i>:</p> <p>(i) the regulatory requirements of that state or territory applicable to an undertaking carrying on <i>direct insurance business</i> (even if it only carries on <i>reinsurance business</i> or is an <i>insurance holding company</i>), or</p> <p>(ii) the requirements referred to in (b); and</p>

	<p>(b) in the case of any other <i>insurance undertaking</i> or <i>insurance holding company</i>, the rules in <i>IPRU(INS)</i> applicable to an <i>insurer</i> (<u>other than a <i>pure reinsurer</i></u>) with its head office in the United Kingdom (whether or not it is such an <i>insurer</i>)</p>
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## Annex 4

### Proposed amendments to the Supervision manual (SUP) and the Interim Prudential sourcebook for Banks (IPRU(BANK))

The amendments shown below are explained in Chapter 4. Underlining indicates new text and striking-out indicates deleted text.

#### Part A: Proposed amendments to SUP

In SUP 16, make the following changes

**16.7.12 R Table: Financial reports from a bank established outside the EEA (see SUP 16.7.11R):**

Content of report	Form (Note)	Frequency	Due date
<u>Annual report and audited accounts, in English</u>	<u>N/A</u>	<u>Annually</u>	<u>9 months after the firm's accounting reference date</u>
...			

**16.7.13 R Method of submission**

*A bank, other than an EEA bank with permission for cross-border services only, must submit the reports described in SUP 16.7.8R, SUP 16.7.10R and SUP 16.7.12R to the following:*

- (1) ...

...

~~Electronic submission to the Bank of England~~

**16.7.15 R A bank must submit the reports referred to in SUP 16.7.13R(1) either:**

- (1) on paper by post, or by hand delivery to the Bank of England on any business day between 9am and 5pm; or
- (2) in electronic format using the specifications for the Bank of England Reporting System and sent either
- (a) by the AT&T Global Network to one of the addresses specified in the above specification; ~~or~~
- (b) by e-mail to mfsd\_beers@bofe.co.uk; or

- (c) **on computer diskette but to paper reporting deadlines by post, or by hand delivery to the Bank of England on any business day between 9am and 5pm.**

...

- 16.7.19 R A building society must submit the reports in SUP 16.7.17R (other than the “analysis of interest rate gap”) either:**
- (1) by means of the Remote Data entry system supplied by the FSA (and previously the Building Societies Commission); or, should this be inoperable**
  - (2) by post or fax to the address in SUP 16.3.10R using:**
    - (a) ~~the pre-printed forms supplied by the FSA for that purpose~~ the corresponding forms available from the FSA’s website; or**
    - (b) its own version of the FSA’s specified forms, provided that the version is equivalent in terms of content and layout.**

**Notwithstanding a paper submission in accordance with (2), once the Remote Data Entry system is operable again, the reports must be submitted by its means.**

In SUP16 Annex1R

In Form BSD3, amend pages 1, 42, 44 and 46 as shown on the forms at [www.fsa.gov.uk/pubs/CP/199/index](http://www.fsa.gov.uk/pubs/CP/199/index).

In SUP16, Annex 2G

1 – Form B7 – definitions

...

## **1.6 Other operating income**

Investment securities are defined as securities intended for use on a continuing basis in the activities of the bank, but securities should not be treated as investment securities unless they are held for identified purpose and the securities held are clearly identifiable. From March 2004, no further breakdown of this figure is needed. ~~Amounts within other operating income that represent more than 5% of the total income figure (item 1) should be entered in items 1.6A, 1.6B and 1.6C in descending order of size. Ignore further items if there are more than three breaking the 5% limit.~~

...

## **2.7 Other operating charges**

Include here those items of expenditure which do not fall within items 2.1 to 2.56. No further breakdown of this figure is needed from March 2004. ~~Amounts within other operating charges which represent more than 5% of the total expenditure figure (item 2) should be entered in items 2.7A, 2.7B and 2.7C in descending order of size. Ignore further items if there are more than three breaking the 5% limit.~~

...

## **LARGE EXPOSURES**

### **11 Twenty largest exposures to banks and building societies**

~~From March 2004, this item should not be completed. List in descending order of magnitude (ie the largest exposure first) the twenty largest credit exposures to banks and building societies. The listing should commence on line 11A. Each large exposure should only be reported once, at the top level. The total of each column of the large exposures should be entered on the first line.~~

~~For the definitions of exposures and counterparties which should be used (see SGN9 to SGN13), for banks, see SGN20 (excluding investment firms).~~

~~Exposures of up to and including 1 year remaining maturity at the reporting date should be reported in column 4.~~

~~For interest rate and foreign exchange rate contracts, the amounts at risk should be reported as the "credit equivalent amount" using the same basis of valuation as in item 9.~~

### **12 Twenty largest exposures to other counterparties**

~~From March 2004, this item should not be completed. List in descending order of magnitude (ie the largest exposure first) the twenty largest credit exposures to counterparties other than those covered in item 11 (both UK and overseas). Include the non-bank private sector, central banks, international organisations (including regional development banks and the Bank for International Settlements (BIS)), and the UK and overseas public sectors. The listing should commence on line 12A. Each large exposure should only be reported once, at the top level. The total of each column of the large exposures should be entered on the first line.~~

~~See SGN9 to SGN13, SGN18, SGN20 to SGN23.~~

~~Exposures of up to and including 1 year remaining maturity at the reporting date should be reported in column 4.~~

For interest rate and foreign exchange rate contracts, the amounts at risk should be reported as the “credit equivalent amount” using the same basis of valuation as in item 9.

Exposures should be valued in accordance with the Supervisory Guidance Notes, except that, in the circumstances below, the exposure should be measured as less than the nominal exposure. In reporting large exposures, credit balances should not be offset against debit balances unless consistent with Chapter NE (Collateral and netting) of the FSA Banking Supervisory Policy Guide or the Interim Prudential Sourcebook for Banks, whichever is current at the reporting date.

#### Underwriting commitments

The exposure arising from underwriting commitments should be taken as the full amount of the sum underwritten, less amounts of the issue which the reporting bank has sub-underwritten with, or sold to, another counterparty.

...

#### 1 - Form B7 – Validations

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28	<del>11LE1</del>	=	<del>11LE1A + 11LE1B + 11LE1C + 11LE1D + 11LE1E + 11LE1F + 11LE1G + 11LE1H + 11LE1J + 11LE1K + 11LE1L + 11LE1M + 11LE1N + 11LE1P + 11LE1Q + 11LE1R + 11LE1S + 11LE1T + 11LE1U + 11LE1V</del> <u>Removed March 2004</u>
29	<del>11LE2</del>	=	<del>11LE2A + 11LE2B + 11LE2C + 11LE2D + 11LE2E + 11LE2F + 11LE2G + 11LE2H + 11LE2J + 11LE2K + 11LE2L + 11LE2M + 11LE2N + 11LE2P + 11LE2Q + 11LE2R + 11LE2S + 11LE2T + 11LE2U + 11LE2V</del> <u>Removed March 2004</u>
30	<del>11LE3</del>	=	<del>11LE3A + 11LE3B + 11LE3C + 11LE3D + 11LE3E + 11LE3F + 11LE3G + 11LE3H + 11LE3J + 11LE3K + 11LE3L + 11LE3M + 11LE3N + 11LE3P + 11LE3Q + 11LE3R + 11LE3S + 11LE3T + 11LE3U + 11LE3V</del> <u>Removed March 2004</u>
31	<del>11LE4</del>	=	<del>11LE4A + 11LE4B + 11LE4C + 11LE4D + 11LE4E + 11LE4F + 11LE4G + 11LE4H + 11LE4J + 11LE4K + 11LE4L + 11LE4M + 11LE4N + 11LE4P + 11LE4Q + 11LE4R + 11LE4S + 11LE4T + 11LE4U + 11LE4V</del> <u>Removed March 2004</u>
32	<del>11LE5</del>	=	<del>11LE5A + 11LE5B + 11LE5C + 11LE5D + 11LE5E + 11LE5F + 11LE5G + 11LE5H + 11LE5J + 11LE5K + 11LE5L + 11LE5M + 11LE5N + 11LE5P + 11LE5Q + 11LE5R + 11LE5S + 11LE5T + 11LE5U + 11LE5V</del> <u>Removed March 2004</u>
33	<del>12LE1</del>	=	<del>12LE1A + 12LE1B + 12LE1C + 12LE1D + 12LE1E + 12LE1F + 12LE1G + 12LE1H + 12LE1J + 12LE1K + 12LE1L + 12LE1M + 12LE1N + 12LE1P + 12LE1Q + 12LE1R + 12LE1S + 12LE1T + 12LE1U + 12LE1V</del> <u>Removed March 2004</u>
34	<del>12LE2</del>	=	<del>12LE2A + 12LE2B + 12LE2C + 12LE2D + 12LE2E + 12LE2F + 12LE2G + 12LE2H + 12LE2J + 12LE2K + 12LE2L + 12LE2M + 12LE2N + 12LE2P + 12LE2Q + 12LE2R + 12LE2S + 12LE2T + 12LE2U + 12LE2V</del> <u>Removed March 2004</u>

35	<del>12LE3</del>	=	<del>12LE3A + 12LE3B + 12LE3C + 12LE3D + 12LE3E + 12LE3F + 12LE3G + 12LE3H + 12LE3J + 12LE3K + 12LE3L + 12LE3M + 12LE3N + 12LE3P + 12LE3Q + 12LE3R + 12LE3S + 12LE3T + 12LE3U + 12LE3V</del> <u>Removed March 2004</u>
36	<del>12LE4</del>	=	<del>12LE4A + 12LE4B + 12LE4C + 12LE4D + 12LE4E + 12LE4F + 12LE4G + 12LE4H + 12LE4J + 12LE4K + 12LE4L + 12LE4M + 12LE4N + 12LE4P + 12LE4Q + 12LE4R + 12LE4S + 12LE4T + 12LE4U + 12LE4V</del> <u>Removed March 2004</u>
37	<del>12LE5</del>	=	<del>12LE5A + 12LE5B + 12LE5C + 12LE5D + 12LE5E + 12LE5F + 12LE5G + 12LE5H + 12LE5J + 12LE5K + 12LE5L + 12LE5M + 12LE5N + 12LE5P + 12LE5Q + 12LE5R + 12LE5S + 12LE5T + 12LE5U + 12LE5V</del> <u>Removed March 2004</u>
38	8	=	8.1 + 8.2 + 8.3 + 8.4 + 8.5 (Replaces validation 8, SRN/2001/1)
39	<del>1.6A</del>	#	<del>1.6 (Replaces validation 20, SRN/2001/1)</del> <u>Removed March 2004</u>
40	<del>1.6B</del>	#	<del>1.6 (Replaces validation 21, SRN/2001/1)</del> <u>Removed March 2004</u>
41	<del>1.6C</del>	#	<del>1.6 (Replaces validation 22, SRN/2001/1)</del> <u>Removed March 2004</u>
42	1.6	←	<del>1.6A + 1.6B + 1.6C (Replaces validation 23, SRN/2001/1)</del> <u>Removed March 2004</u>
43	<del>2.7A</del>	#	<del>2.7 (Replaces validation 24, SRN/2001/1)</del> <u>Removed March 2004</u>
44	<del>2.7B</del>	#	<del>2.7 (Replaces validation 25, SRN/2001/1)</del> <u>Removed March 2004</u>
45	<del>2.7C</del>	#	<del>2.7 (Replaces validation 26, SRN/2001/1)</del> <u>Removed March 2004</u>
46	2.7	←	<del>2.7A + 2.7B + 2.7C (Replaces validation 27, SRN/2001/1)</del> <u>Removed March 2004</u>

...

## 2 Form BSD3 - definitions

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### BSD Section A: Banking Book

...

#### **A330 Encumbered assets**

List in these lines any assets not freely available to meet the claims of the generality of creditors in a liquidation of the reporting institution because they are subject to charge, pledge or other restriction.

From March 2004, no further breakdown is needed for this item. So items A330.1 and A 330.2 should be zero. ~~Under item A330.1, list the assets and the item number (indicating whether in the Banking Book or Trading Book) within the return to which they refer, which have been given as security in connection with the reporting institution's participation in a payments/settlements system such as CREST or Euroclear. The particular payments/settlements system should be listed with the liabilities being secured at the reporting date recorded under column 1. For the~~

~~purposes of detailing the total amount of assets securing liabilities, assets pledged in excess of the actual liability to individual systems at the reporting date should not be reported.~~

~~Under item A330.2, list the assets and the item number on the return to which they refer, which have been given as security to secure the reporting institution's other liabilities (for example, property which has been mortgaged and hire purchase agreements pledged as collateral). Assets reported should exclude any element of unearned finance charges.~~

~~Total liabilities being secured at the reporting date (item A330, column 1) should equal the sum of items A330.1 and A330.2 below. Total assets at the reporting date securing liabilities reported in column 1 (item A330, column 2) will not necessarily equal the sum of items A330.1 and A330.2 below as any asset which is securing more than one creditor should not be double counted in the total.~~

...

#### **A790 Subordinated term debt**

~~Dated preference shares and subordinated, unsecured loan stocks of over 5 years' original maturity issued by the reporting institution should be shown after amortisation in item A790.2. From March 2004, no further breakdown of this figure is needed. So items A790.21 and A790.22 should be zero. The amount shown in item A790.2 should be further divided between items A790.21 and A790.22 as necessary in the relevant sub-total boxes. The amount of principal outstanding before amortisation should also be entered in the sub-total boxes in the "amount" column in the currency of repayment, which should be entered in the "currency" column. The "sterling equivalent" is then this amount converted to sterling at the current exchange rate for the currency concerned on the day of the report unless, via a subordinated swap or some other hedging mechanism that is an integral part of the original preference share or subordinated loan stock agreement, the exchange rate has effectively been fixed in which case that fixed rate may with be used. The reporting institution should obtain the FSA's agreement before doing this.~~

~~Individual stocks which are repayable in full on maturity should be listed in item A790.21 in lines a to e. Where there are more than five stocks issued (ie a to e) annotate the form "see attached list" in this section and attach a full list of such stocks. The amounts to be reported after amortisation are shown below and relate to the period between the date of the return and maturity date:~~

<del>Years to maturity</del>	<del>Amortised amount</del>
<del>more than 4</del>	<del>100% of nominal</del>

<del>less than and including 4 but more than 3</del>	<del>80% of nominal</del>
<del>less than and including 3 but more than 2</del>	<del>60% of nominal</del>
<del>less than and including 2 but more than 1</del>	<del>40% of nominal</del>
<del>less than and including 1</del>	<del>20% of nominal</del>

~~The amount of subordinated, unsecured loan stock should be multiplied by the amortisation values shown above. In the case of optional repayment dates the longest date should be used to determine the final maturity if the exercise of the option lies with the issuer, and the shortest date if with investors.~~

~~Report in item A790.22 in lines a to h the original outstanding value of individual stocks which are repayable in instalments. Where banks have more than 10 such holdings, they may aggregate the smallest holdings (by value) and record the total under A190.21j and A790.22j. The amortised amount shown should be agreed with the FSA.~~

...

#### APPENDIX B-IV: COUNTERPARTY RISK ON REPOS AND REVERSE REPOS

...

##### Counterparty Risk On Documented Repos/Reverse Repos

...

When completing Lines 60 to 90 and Lines 110 to 140, ~~it should be assumed that each individual repo or reverse repo cannot be over collateralised in the absence of netting any over-collateralisation should be shown.~~ However, ~~Regarding regarding~~ repos (lines 60 to 90): if collateral held is worth more than 100% of the market value of the securities sold or lent, then ~~the reported value of the collateral on that deal should be the same as the market value of the securities~~ the figure reported as the amount at risk in Column 3 should be the higher of zero or the excess of column 1 over column 2. Excess collateral held for a repo with one counterparty should not offset a shortfall in collateral held for another repo with the same counterparty or another counterparty. Regarding reverse repos (lines 110 to 140): if the market value of securities bought or borrowed on a reverse repo is more than 100% of the market value of the collateral given, ~~the reported value of the securities on that deal should be the same as the market value of the collateral~~ the figure reported as the amount at risk in Column 3 should be the higher of zero or the excess of column 1 over column 2. Excess securities received under a reverse repo with one counterparty should not offset a shortfall in securities received under another reverse repo with the same counterparty or another counterparty.

...

In ~~both~~all cases, Column 3 should be Column 1 minus Column 2 (or zero, in the case of items 60 to 90 and 110 to 140 if that is greater). The weighted amount in Column 5 should be the multiple of the amount at risk (Column 3) and the Weight (Column 4). Item 100 is the sum of the Weighted Amount (Column 5) in rows 60 to 90. Item 150 is the sum of the Weighted Amount (Column 5) in rows 110 to 140.

...

BSD Section C – Consolidation via aggregation plus into the trading book

...

**Column B**    ~~Trigger~~Individual capital ratio applied

Where the *FSA*'s requirements are applied, the ~~trigger~~individual capital ratio applied should be the consolidated Trading Book ~~trigger ratio~~individual capital ratio. The ratio (ie percentage rounded to 2 decimal places) should be multiplied by 100 and reported as integers (eg, a ratio of 8.50% should be reported as 850).

...

**Column C**    ~~Trigger~~Individual capital requirement

Institutions should report here for each subsidiary the total capital requirement set by the supervisor whose rules or requirements are applied. If the *FSA* requirements are applied, the capital charges should be calculated for the subsidiary in accordance with Chapters CS (Consolidated supervision) and CO (Capital adequacy overview) of ~~the FSA Policy Guide~~IPRU(BANK) and should be scaled up (ie the capital charge divided by 8% and multiplied by the ~~trigger~~individual capital ratio) by the institution's consolidated Trading Book ~~trigger~~individual capital ratio.

If another (CAD-equivalent) supervisor's rules are applied, the capital requirement is the amount set by that supervisor. *FSA*'s consolidated Trading Book ~~trigger~~individual capital ratio should not be applied.

...

**Column L**                                    **Target capital requirement**

For banks which have been set a Trading Book individual capital requirement, this column should equal Column C. Report here the capital requirement when the target ratio is applied. Where the *FSA* requirements are applied to a subsidiary, the capital requirements reported in column C should be multiplied by the consolidated Trading

Book target ratio and divided by the consolidated Trading Book ~~trigger~~ individual capital ratio. Capital requirements for subsidiaries consolidated using local regulators' rules need not be scaled up.

...

Section D: Capital adequacy summary

...

**D50 Banking Book ~~trigger~~ individual capital ratio**

This item equals the Banking Book ~~trigger~~ individual capital ratio (formerly the trigger ratio) set by the *FSA*. The ratio (ie percentage rounded to 2 decimal places) should be multiplied by 100 and reported as integers (eg, a ratio of 10.5% should be reported as 1050).

**D60 Banking Book target ratio**

Where an institution has had an individual capital ratio set by the *FSA*, this box should be left blank (ie zero). Prior to the introduction of individual capital ratios, ~~This~~ this item equals the Banking Book target ratio set by the *FSA*. The ratio (ie percentage rounded to 2 decimal places) should be multiplied by 100 and reported as integers (eg, a ratio of 12% should be reported as 1200).

...

**D140 Trading Book ~~trigger~~ individual capital ratio**

This is the Trading Book individual capital ~~trigger~~ ratio set by the *FSA* for CAD banks. The ratio (ie percentage rounded to 2 decimal places) should be multiplied by 100 and reported as integers (eg, a ratio of 11% should be reported as 1100).

**D150 Trading Book target ratio**

Where an institution has a Trading Book individual capital ~~target~~ ratio set by the *FSA* for CAD banks, this box should be left blank (ie zero). Prior to the introduction of Trading Book individual capital ratios, this item equalled the Trading Book target ratio set by the *FSA*. The ratio (ie percentage rounded to 2 decimal places) should be multiplied by 100 and reported as integers (eg, a ratio of 11.50% should be reported as 1150).

...

### D530 ~~Trigger~~ Individual capital adequacy ratio

This is the institution's capital adequacy relative to its individual capital ~~trigger~~ requirements. It is the ratio of the institution's adjusted capital base to its supervisory capital requirement according to the ~~trigger~~ individual capital ratios set by the FSA (or by the local regulator for entities consolidated using the aggregation plus methodology). The ratio is expressed as a percentage: an institution with a ~~trigger~~ an individual capital adequacy ratio less than 100 has insufficient capital to meet its regulatory requirements and it should contact its line supervisor immediately. This item should equal (item D490 multiplied by 100) and divided by item D500.

...

### D540 ~~Target capital adequacy ratio~~

~~This is the institution's capital adequacy relative to its supervisory target capital requirements. It is the ratio of the institution's adjusted capital base to its supervisory capital requirement according to the target ratios set by the FSA. The ratio is expressed as a percentage: an institution with a target capital adequacy ratio less than 100 has insufficient capital to meet its regulatory requirements and it should contact its line supervisor immediately. This item should equal item D490 multiplied by 100 and divided by the sum of (item D70 multiplied by item D60/1000, item D150 divided by item D140 and multiplied by items [D220 plus D250], and item C30 column L).~~

~~The ratio (ie percentage rounded to 2 decimal places) should be multiplied by 100 and reported as integers (eg, a ratio of 105.35% should be reported as 110535).~~

For institutions where an individual capital ratio has been set by the FSA this item, like items D60 and D150, should be left blank (ie be zero).

## 2 - Form BSD3 – validations

...

### Section A: Banking Book Internal validations

...

30	A330.01	= A330.11 + A330.21 <u>Removed March 2004</u>
31	A330.02	<del>A</del> A330.12 + A330.22 <u>Removed March 2004</u>
32	A330.01	<del>A</del> A770 <u>Removed March 2004</u>
33	A330.02	<del>A</del> AB270 + AT270 <u>Removed March 2004</u>

...  
 67            A790.2            = ~~AA790.21 + AA790.22~~ Removed March 2004

...  
 71            A472            = 0 (from SRN/1999/2)  
 72            A474            = 0 (from SRN/1999/2)

...  
**Appendix A-V Validations**

...  
 4            ~~150~~            = ~~80S~~ (Withdrawn March 2004)

**APPENDIX B-IV VALIDATIONS**

...  
 12            ~~A60~~            = ~~S60 - C60~~ Replaced by validation 30, March 2004  
 13            W60            = Zero  
 14            ~~A70~~            = ~~S70 - C70~~ Replaced by validation 31, March 2004  
 15            ~~W70~~            = ~~10% x (S70 - C70)~~ Replaced by validation 32, March 2004  
 16            ~~A80~~            = ~~S80 - C80~~ Replaced by validation 33, March 2004  
 17            ~~W80~~            = ~~20% x (S80 - C80)~~ Replaced by validation 34, March 2004  
 18            ~~A90~~            = ~~S90 - C90~~ Replaced by validation 35, March 2004  
 19            ~~W90~~            = ~~S90 - C90~~ Replaced by validation 36, March 2004  
 20            W100            = W60 + W70 + W80 + W90  
 21            ~~A110~~            = ~~C110 - S110~~ Replaced by validation 37, March 2004  
 22            W110            = Zero  
 23            ~~A120~~            = ~~C120 - S120~~ Replaced by validation 38, March 2004  
 24            ~~W120~~            = ~~10% x (C120 - S120)~~ Replaced by validation 39, March 2004  
 25            ~~A130~~            = ~~C130 - S130~~ Replaced by validation 40, March 2004  
 26            ~~W130~~            = ~~20% x (C130 - S130)~~ Replaced by validation 41, March 2004  
 27            ~~A140~~            = ~~C140 - S140~~ Replaced by validation 42, March 2004  
 28            ~~W140~~            = ~~C140 - S140~~ Replaced by validation 43, March 2004  
 29            W150            = W110 + W120 + W130 + W140  
 30            A60            = S60 - C60 if positive, else zero Introduced March 2004  
 31            A70            = S70 - C70 if positive, else zero Introduced March 2004

32	<u>W70</u>	<u>= 10% x (S70 – C70) if positive, else zero</u> Introduced March 2004
33	<u>A80</u>	<u>= S80 – C80 if positive, else zero</u> Introduced March 2004
34	<u>W80</u>	<u>= 20% x (S80 – C80) if positive, else zero</u> Introduced March 2004
35	<u>A90</u>	<u>= S90 – C90 if positive, else zero</u> Introduced March 2004
36	<u>W90</u>	<u>= S90 – C90 if positive, else zero</u> Introduced March 2004
37	<u>A110</u>	<u>= S110 – C110 if positive, else zero</u> Introduced March 2004
38	<u>A120</u>	<u>= S120 – C120 if positive, else zero</u> Introduced March 2004
39	<u>W120</u>	<u>= 10% x (S120 - C120) if positive, else zero</u> Introduced March 2004
40	<u>A130</u>	<u>= S130 – C130 if positive, else zero</u> Introduced March 2004
41	<u>W130</u>	<u>= 20% x (S130 – C130) if positive, else zero</u> Introduced March 2004
42	<u>A140</u>	<u>= S140 – C140 if positive, else zero</u> Introduced March 2004
43	<u>W140</u>	<u>= S140 – C140 if positive, else zero</u> Introduced March 2004

...

#### 5 – Form LR – Definitions

...

#### **D1F Total deposits**

...

(f) All other issues of commercial paper and medium term notes, bonds, FRNs and other instruments, with the exception of subordinated loan capital of over two years' original maturity;

~~(g) Working capital provided by non-resident offices of the reporting institution.~~

~~Exclude any certificates of deposit which the reporting institution holds which it itself has issued;~~

(a) Any certificates of deposit which the reporting institution holds which it itself has issued;

(b) Working capital provided by non-resident offices of the reporting institution.

...

#### 6 – Form M1 – Definitions

...

#### **80 Holdings in excess of 10% of other credit and financial institutions' capital**

This is the value of all holdings in List all credit and financial institutions in which the reporting institution has direct or indirect holdings which amount to more than 10% of

the acquired institutions' capital; ~~this the~~ calculations may be based on information contained in public financial statements. Identify both the total value of the holdings and the amount by which they exceed 10% of the other credit or financial institutions' capital. Details of individual holdings are not needed from March 2004. ~~Where banks have more than 10 such holdings, they may aggregate the smallest holdings (by value) and record the total under 80.10.~~

...

**140 Five largest holdings in credit and financial institutions, at reporting date**

~~From March 2004, this item should be zero, as no details are needed thereafter. Include the five largest holdings (taking direct and indirect together) in credit and financial institutions, ranked by the value of holdings. Include holdings taken in the Banking and Trading Books. Include the name of the credit and financial institution and the book value of the reporting institution's holding. Banks may agree a de minimis reporting level with their line supervisor.~~

6 – Form M1 – validations

...

**Internal validations**

...

3            80            = ~~80.01E + 80.02 E+ 80.03E + 80.04 E + 80.05E + 80.06E + 80.07E + 80.08E + 80.09E + 80.10E~~ Removed March 2004

...

6            ~~130~~            = ~~70-70.4-100~~ Replaced by validation 13, March 2004

...

13            130            = 70-70.4-110 From March 2004

7 - Supervisory Guidance Notes

...

3            The reporting dates for the various supervisory returns are set out on the front of the individual forms and are ~~summarised below.~~ The reporting schedule for January 2001 to December 2001 is contained in Appendix I, detailed in SUP 16.7.

<b>Frequency</b>	<b>Report</b>	<b>Reporting dates</b>	<b>Basis of reporting</b>
Monthly	SLR1	Second Wednesday	Consolidated (unless agreed otherwise), UK banks
Quarterly	BSD3, M1	End calendar quarters, or at dates coinciding with the financial year end	Unconsolidated or solo-consolidated, UK banks
	LE2	End calendar quarters, or at dates coinciding with the financial year end	Unconsolidated or solo-consolidated and consolidated, UK banks
	LR	End February, May, August and November for Form BT monthly reporter, or end calendar quarters for Form BT quarterly reporter	Unconsolidated including any overseas branches or solo-consolidated if capital and large exposures are reported on a solo-consolidated basis (UK banks), or business conducted by EEA banks and banks established outside the EEA
Half-yearly	BSD3, M1	End June and December, or at dates coinciding with the financial year end	Consolidated, UK banks
	B7	End June and December, or at dates coinciding with accounting periods	UK branches of banks incorporated outside the EEA <sup>†</sup> (banks established outside the EEA)

Footnote 1    ~~The EEA comprises the European Union and Norway, Iceland and Liechtenstein.~~

Note: As a consequence of removing this footnote, all subsequent footnotes in the Supervisory Reporting Notes will be renumbered.

...

## Appendix D

...

### European Union

...

Greece	Bank of Greece
Ireland	<u>Central Bank of Ireland</u> <u>Central Bank and Financial Services Authority of Ireland</u>

...

## Appendix G

### Eligible banks (banks whose acceptances are eligible for discount at the Bank of England)

An up-to-date list of eligible banks is available from the Bank of England's Internet site on [www.bankofengland.co.uk/markets/money/eligiblebanks.htm](http://www.bankofengland.co.uk/markets/money/eligiblebanks.htm).

This list (21 May 2001) is issued by the Bank of England.

An institution's appearance on the list should not be misconstrued as evidence that it is qualitatively different in terms of financial soundness, standards of conduct or otherwise, from institutions which are not included on the list. The inclusion of an institution on this list does not mean that the Bank of England in any way guarantees its obligations.

ABN AMRO Bank NV	Robert Fleming & Co Ltd
Allied Irish Banks plc	Fortis Bank S.A./N.V.
The Asahi Bank, Ltd	The Fuji Bank, Ltd
Australia & New Zealand Banking Group Ltd	Halifax plc
Banca di Roma SpA	HSBC Bank plc
Banca Nazionale del Lavoro SpA	The Industrial Bank of Japan, Ltd
Banco Bilbao Vizcaya Argentaria SA	ING Bank NV
Banco Santander Central Hispano SA	IntesaBei SpA (Banca Intesa Banca Commerciale Italiana SpA)
Bank Austria AG	KBC Bank NV
Bank Brussels Lambert	Lloyds TSB Bank plc
Bank of America, NA	Lloyds TSB Scotland plc
The Bank of Ireland	Mellon Bank, NA
Bank of Montreal	Merita Bank plc
The Bank of Nova Scotia	The Mitsubishi Trust and Banking Corporation
Bank One, NA	Natexis Banques Populaires
Bank of Scotland	National Australia Bank Ltd
The Bank of Tokyo - Mitsubishi, Ltd	National Westminster Bank plc
Barelays Bank plc	Northern Bank Ltd
Bayerische Hypo und Vereinsbank AG	Rabobank International (Coöperatieve Centrale Raiffeisen Boerenleenbank BA)
Bayerische Landesbank Girozentrale	N M Rothschild & Sons Ltd
BNP Paribas	

Brown, Shipley & Co Ltd	Royal Bank of Canada
The Chase Manhattan Bank	The Royal Bank of Scotland plc
CIBC World Markets plc	Sanpaolo IMI SpA
Citibank NA	The Sanwa Bank, Ltd
Clydesdale Bank plc	Singer & Friedlander Ltd
Commerzbank AG	Skandinaviska Enskilda Banken AB (publ)
Commonwealth Bank of Australia	Société Générale
The Co-operative Bank plc	Standard Chartered Bank
Crédit Agricole Indosuez	Sumitomo Mitsui Banking Corporation
Crédit Industriel et Commercial	The Sumitomo Trust & Banking Co Ltd
Crédit Lyonnais	Svenska Handelsbanken AB (publ)
Credit Suisse First Boston	The Tokai Bank, Ltd
The Dai Ichi Kangyo Bank, Ltd	The Toronto-Dominion Bank
Danske Bank A/S	UBS AG
Den norske Bank ASA	UniCredito Italiano SpA
Deutsche Bank AG	Westdeutsche Landesbank Girozentrale
Dexia Banque Internationale à Luxembourg SA	Westpac Banking Corporation
Dresdner Bank AG	Yorkshire Bank plc <sup>2</sup>
Fleet National Bank	

...

## Appendix I

### Reporting schedule for supervisory returns 2001

- ~~This schedule covers the period from **January 2001 to December 2001**. Not all the forms listed may be required from every reporting institution. The most common exceptions are covered in the footnotes. Individual reporting institutions which have been requested specifically by the FSA not to complete certain forms, or complete them less frequently or at different days from those shown below, should continue to follow their special arrangements.~~
- ~~The submission of these forms is covered by the rules and guidance set out in SUP 16.7.7R — SUP 16.7.15R. Failure to submit a report in accordance with the rules in SUP Chapter 16 may lead to the imposition of a financial penalty and other disciplinary actions (see ENF 13.5) once the Financial Services and Markets Act 2001 comes into force.~~
- ~~**Institutions should note that the due dates set out below are based on the Bank Holidays applicable in England. The due dates should be adjusted to take account of local Bank Holidays (but not Public Holidays) and any waivers or concessions agreed with the FSA.** Reporting institutions should telephone their regular supervisor in the FSA in advance of any difficulty they may have in meeting a deadline.~~
- ~~Banks with any questions on this reporting schedule may also ring Financial Risk Analysis and Monitoring Unit, FSA on 020 7676 0660.~~

Reporting date	Forms	Due dates					
		<u>Paper reporters</u>		<u>Electronic reporters</u>		<u>Submitted to FSA</u>	
<u>2001</u>						Via MFSD, Bank of England	Direct to supervisor at FSA
JANUARY — 10	SLR1 <sup>1</sup>	Thursday	18/01/01	Thursday	18/01/01	X	
FEBRUARY — 14	SLR1 <sup>1</sup>	Thursday	22/02/01	Thursday	22/02/01	X	
— 28	LR <sup>2</sup>	Wednesday	14/03/01	Friday	16/03/01	X	
MARCH — 14	SLR1 <sup>1</sup>	Thursday	22/03/01	Thursday	22/03/01	X	
— 30	BSD <sup>3</sup> , M1 <sup>3,4</sup> , LR <sup>7</sup> , B7 <sup>5</sup>	Tuesday	17/04/01	Thursday	19/04/01	X	
— 30	LE2 <sup>6</sup>	Tuesday	17/04/01	Thursday	19/04/01		X <sup>2</sup>

APRIL	11	SLR1 <sup>4</sup>	Monday	23/04/01	Monday	23/04/01	X
MAY	9	SLR1 <sup>4</sup>	Thursday	17/05/01	Thursday	17/05/01	X
	31	LR <sup>8</sup>	Thursday	14/06/01	Monday	18/06/01	X
JUNE	13	SLR1 <sup>4</sup>	Thursday	21/06/01	Thursday	21/06/01	X
	29	BSD3 <sup>3</sup> , M1 <sup>3,4</sup> , LR <sup>7</sup> , B7 <sup>5</sup>	Friday	13/07/01	Tuesday	17/07/01	X
	29	LE2 <sup>6</sup>	Friday	13/07/01	Friday	13/07/01	X <sup>2</sup>
JULY	11	SLR1 <sup>4</sup>	Thursday	19/07/01	Thursday	19/07/01	X
AUGUST	8	SLR1 <sup>4</sup>	Thursday	16/08/01	Thursday	16/08/01	X
	31	LR <sup>8</sup>	Friday	14/09/01	Tuesday	18/09/01	X
SEPTEMBER	12	SLR1 <sup>4</sup>	Thursday	20/09/01	Thursday	20/09/01	X
	28	BSD3 <sup>3</sup> , M1 <sup>3,4</sup> , LR <sup>8</sup> , B7 <sup>5</sup>	Friday	12/10/01	Tuesday	16/10/01	X
	28	LE2 <sup>6</sup>	Friday	12/10/01	Friday	12/10/01	X <sup>2</sup>
OCTOBER	10	SLR1 <sup>4</sup>	Thursday	18/10/01	Thursday	1/10/01	X
NOVEMBER	14	SLR1 <sup>4</sup>	Thursday	22/11/01	Thursday	22/11/01	X
	30	LR <sup>8</sup>	Friday	14/12/01	Tuesday	18/12/01	X
DECEMBER	12	SLR1 <sup>4</sup>	Thursday	20/12/01	Thursday	20/12/01	X
	31	BSD3 <sup>3</sup> , M1 <sup>3,4</sup> , LR <sup>7</sup> , B7 <sup>5</sup>	Tuesday	15/01/02	Thursday	17/01/02	X
	31	LE2 <sup>6</sup>	Tuesday	15/01/02	Tuesday	15/01/02	X <sup>2</sup>

For footnotes, see over.

1. Form SLR1 should also be completed for any exception during the month. These exception reports should be submitted directly to your supervisor (and not the Bank of England).
2. Until notified by the FSA, these returns should be sent direct to your supervisor.
3. Forms BSD3 and M1 apply only to UK banks. They may be submitted alternatively on a different quarterly cycle to coincide with a reporting institution's accounting year end. Institutions wishing to report at dates which coincide with the financial year end should agree this with the FSA. For institutions reporting on an unconsolidated / solo consolidated basis, these forms must be completed within 10 business days of the reporting date (12 business days if reported electronically). Institutions reporting on a consolidated basis are required to submit Forms BSD3 and M1 at the reporting group's accounting year end and half year end. The consolidated forms must be returned within 20 business days of the reporting date (22 business days for electronic reporters).
4. Form M1 applies only to market makers holding loan capital issued by banks and non-resident banks. These reporting institutions are required to submit Form M1 in conjunction with Form BSD3.
5. Form B7 applies only to UK branches of banks established outside the EEA. Banks may complete Form B7 at dates coinciding with their accounting year end: this should be agreed with the FSA.
6. Form LE2 applies only to UK banks. Those banks which complete Form LE2 on an unconsolidated basis should report at dates which coincide with Form BSD3. The form must be completed within 10 business days of the reporting date on an unconsolidated / solo consolidated basis, or 20 business days when completed on a consolidated basis.
7. Banks (other than those which report to the Bank of England on Form BT quarterly), should complete the Form LR as at end February, May, August and November. For those banks reporting to the Bank of England on Form BT quarterly, Form LR should be completed at end March, June, September and December.
8. These returns should be sent direct to your supervisor unless the FSA has requested otherwise.
9. Forms BSD3 and M1 apply only to UK banks. They may be submitted alternatively on a different quarterly cycle to coincide with a reporting institution's accounting year end. Institutions wishing to report at dates which coincide with the financial year end should agree this with the FSA. For institutions reporting on an unconsolidated / solo consolidated basis, these forms must be completed within 10 business days of the reporting date (12 business days if reported electronically). Institutions reporting on a consolidated basis are required to submit Forms BSD3 and M1 at the reporting group's accounting year end and half year end. The consolidated forms must be returned within 20 business days of the reporting date (22 business days for electronic reporters).
10. Form M1 applies only to UK banks which have been granted a trading book concession, or have qualifying holdings in non-financial companies. These reporting institutions are required to submit Form M1 in conjunction with Form BSD3.

SUP 16.7 sets out the submission times allowed for the various reports required from banks.

## Part B: Proposed amendments to IPRU(BANK)

In Chapter GN of *IPRU (BANK)*, change the text as follows:

...

3.4.12R A bank must send to the *FSA*:

(a) a copy of the policy statement it has first adopted in compliance with each of *IPRU (BANK)* 3.4.1R, 3.4.3R, 3.4.5R and 3.4.7R as soon as possible after adopting it; and

(b) ~~a copy of the current version of the policy statement annually, at the start of each calendar year. If, during that year, if the policy statement is significantly amended~~ subject to significant changes, a bank must send a copy of the amended policy statement to the *FSA* as soon as possible after adopting it. A significant change would include, for instance, new types of customers or business requiring different funding or provisioning. If there is any doubt about whether a change is significant or not, it must be treated as significant.

~~3.4.13G — Where a policy statement that a bank is required to have under each of *IPRU (BANK)* 3.4.1R, 3.4.3R, 3.4.5R and 3.4.7R remains unchanged, it should still send a copy of the policy statement annually to the *FSA*.~~

...

In Chapter LE of *IPRU (BANK)*, change the text as follows:

### Section 3

...

~~12 — The *FSA* reviews annually each bank's large exposures policy statement and its lending limits for exempt exposures.~~

...

### Section 8

...

2 The rules require a bank to have its policy statement approved by its board and to review it at least annually ~~and inform the *FSA* that it has done so.~~ Significant ~~departures from~~ changes to policies, e.g. new types of lending or

~~breaches of existing limits~~, should not be incorporated in a policy statement without prior discussion with the FSA.

...

In Chapter CB of IPRU (BANK), change the text as follows:

## Section 2

...

2 Under rule 3.4.712 in Chapter GN, a UK bank must provide the FSA with a statement of its policy on its trading book. It should agree the statement with the FSA. This statement must be reviewed and, where necessary, updated annually, with any significant changes approved by its board or a body delegated this responsibility by the board. The bank should obtain the FSA's written agreement to the any significant changes made. ~~A bank must inform the FSA when a review has taken place.~~

- a) This applies to all UK banks since the FSA's agreement to a trading book policy statement forms the basis for determining whether it is appropriate for a bank not to apply the CAD trading book treatment.
- i) The policy statement of a bank whose trading activities are judged minimal need only cover certain of the items normally required.

...

8 ~~The FSA reviews annually each bank's trading book policy statement.~~ [This is intentionally blank.]

9 ~~The FSA reviews at least annually the trading activities of a non-CAD bank to ensure that they remain minimal.~~ [This is intentionally blank.]

...

## Section 5

...

3 The policy statement must be reviewed and where necessary updated annually, with ~~major~~ significant changes approved by its board or the body delegated

this responsibility by the board. A bank should seek the FSA's written agreement to it making ~~such any significant~~ changes. ~~Where approval of the changes is delegated, that body should inform the board of any major changes. A bank must inform the FSA when a review has taken place (see 3.4.9E).~~

...

## Annex 5

### Proposed amendments to the Conduct of Business sourcebook (COB) and the Glossary

The amendments shown below are explained in Chapter 5. Underlining indicates new text and striking-out indicates deleted text.

#### Part A: Proposed amendments to COB

Amend COB 5.2.5 R as indicated:

##### Requirement to know your customer

- 5.2.5 R Before a *firm* gives a *personal recommendation* concerning a *designated investment* to a *private customer*, or acts as an *investment manager* for a *private customer*, it must take reasonable steps to ensure that it is in possession of sufficient personal and financial information about that *customer* relevant to the services that the *firm* has offered or agreed to provide.

Amend COB 5.2.9 R as indicated:

##### Record keeping: personal and financial circumstances

- 5.2.9 R ~~(1)~~ (1) ~~Unless (2) applies, a~~ *firm* must make and retain a record of a *private customer's* personal and financial circumstances that it has obtained in satisfying COB 5.2.5 R. The *firm* must retain  
~~The record must be retained~~ for a minimum period after the information is obtained, as follows:
- ~~(1)~~ (a) indefinitely for a record relating to a *pension transfer*, *pension opt-out* or *free-standing additional voluntary contribution (FSAVC)*;
  - ~~(2)~~ (b) six years for a record relating to a *life policy*, *pension contract* or *stakeholder pension scheme*;
  - ~~(3)~~ (c) three years in any other case.
- (2) A *firm* need not retain the record:
- (a) where following a *personal recommendation* to a *private customer* in connection with a *designated investment*, the customer does not proceed with the recommendation or any part of it; or
  - (b) where it has offered or agreed to act as *investment manager* for the *private customer*, but does not do so.

## Part B: Proposed amendment to the Glossary:

Amend the following definition:

*pension transfer*

a transaction resulting from a decision made, with or without advice from a *firm*, by a *customer* who is an individual, to transfer deferred benefits from:

- (a) an *occupational pension scheme*; or
- (b) an *individual pension contract* providing fixed or guaranteed benefits that replaced similar benefits under a *defined benefits pension scheme*; or
- (c) (in COB 6.7 (Cancellation and withdrawal)) a *stakeholder pension scheme* or a *personal pension scheme*)

to a *stakeholder pension scheme* or to a *personal pension scheme* (including a self-invested *personal pension scheme*), or to any deferred annuity policy (including a pension buy-out contract) for a customer who is an individual where the eventual benefits depend in whole or in part on investment performance in the period up to the intended retirement date.

## Annex 6

### Proposed amendments to the Money Laundering sourcebook (ML) and consequential changes

The amendments shown below are explained in Chapter 6. Underlining indicates new text and striking-out indicates deleted text.

#### Part A: Proposed changes to ML

- 1.1.3 G The scope of this sourcebook is very wide. It includes all *firms* except those within the limited exception for *firms* concerned only with certain insurance activities and *UCITS qualifiers* (see *ML* 1.1.2R). In this respect, the chapter follows article 1 of the *Money Laundering Directive* (No 91/308/EEC as amended by No 2001/97/EEC). The scope extends to *incoming firms* (such as branches of institutions established elsewhere in the *EEA*), except those providing only *cross border services* in the *United Kingdom*. This is because the Directive is designed to apply on a “*Host State*” basis. *ML* does not apply with respect to the *unregulated activities* of a *firm*, for example *money service business*.
- ...
- 1.2.4 G This sourcebook relates to regulatory requirements, as opposed to requirements imposed by the criminal law. It is therefore not relevant ~~regulatory or supervisory~~ *guidance* for the purposes of regulation 53(3) of the *Money Laundering Regulations* or section 330(8) of the Proceeds of Crime Act 2002.
- 1.2.5 G In assessing a *relevant firm*'s compliance with the requirements of this sourcebook, the *FSA* will have regard to the relevant provisions of the Joint Money Laundering Steering Group's Guidance Notes for the Financial Sector.
- ...
- 3.1.3 R (2A) **If the *client*, or the *person* on whose behalf he is acting, engages in *money service business* and is registered with the Commissioners of the Customs and Excise, sufficient evidence of identity must include the registered number, within the meaning given by regulation 4(3) 9(2) of the *Money Laundering Regulations 2001*, of the *client* or the *person* on whose behalf he is acting.**
- ...
- 3.1.4 G ~~In assessing a *relevant firm*'s compliance, with its duty to identify a *client* in accordance with *ML* 3.1.3R, the *FSA* will have regard to the *relevant firm*'s compliance with the Joint Money Laundering Steering Group's Guidance Notes for the Financial Sector and with the *guidance* on financial exclusion in *ML* 3.1.5G. [deleted]~~

...

- 3.2.1 R (1) This section sets out circumstances in which:
- (a) the duty in *ML 3.1.3 R (1)* (Identification of the client: the duty) need not be complied with; or
  - (b) ~~The *relevant firm* is entitled to regard the evidence it has as sufficient evidence.~~ the *relevant firm* is required to take reasonable steps to establish the identity of a *person* for whom the *client* is acting.
- 3.2.2 R The duty in *ML 3.1.3 R (1)* (Identification of the client: the duty) does not apply if:
- (1) the *client* is also:
    - (a) a *credit institution* or *financial institution* covered by the *Money Laundering Directive*; or
    - (b) an authorised professional firm; or
    - (c) is regulated by an overseas regulatory authority (see *ML 3.2.7.R*) and is based or incorporated in a country (other than an *EEA State*) whose law contains comparable provisions to those contained in the *Money Laundering Directive*; or
  - (2) the *transaction* is:
    - (a) a one-off *transaction* with a value of less than euro 15,000; or
    - (b) is one of a number of *transactions* which are related and, when taken together, have a value of less than euro 15,000; or
  - (3) with a view to carrying out a one-off *transaction*, the *client* (other than a *money service operator*) is introduced to the *relevant firm* by a *person* who has given the *relevant firm* a written assurance that in all such cases he obtains and records identification evidence, and:
    - (a) the *person* who has given the written assurance is a *credit institution* or *financial institution* covered by the *Money Laundering Directive*, or an *authorised professional firm*, or an entity undertaking comparable activities in an *EEA State*; or
    - (b) ~~the *person* is subject to regulatory oversight exercised by a relevant overseas regulatory authority (see *ML 3.2.7 R*), and to legislation at least equivalent to that required by the *Money Laundering Directive*~~ regulated by an overseas regulatory authority (see *ML 3.2.7R*) and is based or incorporated in a country (other than an *EEA State*) whose law contains comparable provisions to those contained in the *Money Laundering Directive*; or

- (4) the proceeds of a one-off *transaction*;
  - (a) are to be payable to the *client* but are then to be invested on his behalf;
  - (b) are to be the subject of a record; and
  - (c) can thereafter only be reinvested on his behalf or paid directly to him; or
- (5) when the *transaction* concerns a *long-term insurance contract*:
  - (a) taken out in connection with a *pension scheme* relating to the *client's* employment or occupation, if the *policy* contains no surrender clause and cannot be used as security for a loan; or
  - (b) where the *premium* is a single payment of no more than euro 2,500; or
  - (c) where the *premium* payments do not exceed euro 1,000 in any calendar year.

~~When evidence of identity may be regarded as sufficient~~

- 3.2.4 R ~~A relevant firm may regard evidence as sufficient evidence for the purposes of ML 3.1.3R (Identification of the client: the duty) if it establishes that:~~
- ~~(1) — the relevant payment for the *transaction* was made or is to be made —~~
    - ~~(a) a relevant firm with permission to accept deposits; or~~
    - ~~(b) an incoming relevant firm which is a credit institution; or~~
    - ~~(c) a credit institution;~~
  - ~~(2) — the payment has been or will be sent or confirmed by post or electronically;~~
  - ~~(3) it was or is reasonable for the payment to be sent or confirmed in that ————— way; and~~
  - ~~(4) — the payment is not made to open an account from which onward payment may be made to someone other than the *client*. [deleted]~~

Where the client is acting for another person

- 3.2.5 R ~~A relevant firm may regard evidence as sufficient for the purposes of ML 3.1.3 R (Identification of the client: the duty) if it establishes that the *client* (other than a *money service operator*):~~
- ~~(1) — is bound by this sourcebook or by the *Money Laundering Regulations* or is otherwise covered by the *Money Laundering Directive*; or~~
  - ~~(2) — is acting on behalf of another *person*, and has given a written assurance that he has obtained and recorded evidence of the identity of the *person* on whose behalf he is acting, and is subject to regulatory oversight exercised by a relevant overseas regulatory authority (see ML 3.2.7 R) and to legislation at least equivalent to~~

**that required by the Money Laundering Directive. Where the client acts, or appears to act, other than in the circumstances covered by ML 3.2.2R(1) and (3) for another person, the relevant firm must take reasonable steps for the purpose of establishing the identity of that person.**

3.2.6 G ~~A relevant firm is expected to take reasonable steps to determine whether or not the client falls within the exemption in ML 3.2.5 R(2).~~

...

4.1.1 G This section deals with the reporting to the firm's *MLRO* or a *person* authorised by the Director General of *NCIS* of knowledge or suspicions within the *relevant firm* about *money laundering*.

4.1.2 R (1) **A *relevant firm* must take reasonable steps to ensure that any member of staff who handles, or is managerially responsible for handling, transactions which may involve *money laundering* makes a report promptly to the *MLRO* or a *person* authorised by the Director General of *NCIS*, within the same firm or group, if he:**

**(a) knows or suspects; or**

**(b) has reasonable grounds to know or suspect**

**that a *client*, or the *person* on whose behalf the *client* is acting *person* is engaged in *money laundering*.**

....

4.1.3 G A *relevant firm* may wish to set up internal systems that allow its staff to consult with their line manager before sending a report to the *MLRO* or a *person* authorised by the Director General of *NCIS*. If a *relevant firm* sets up such systems, it should ensure that they are not used to prevent reports reaching the *MLRO* or a *person* authorised by the Director General of *NCIS* whenever staff have stated that they have knowledge or suspicion that a *transaction* may involve *money laundering*.

**4.1.4 R (1) The duty in ML 4.1.2R (Internal reporting) does not apply where the relevant firm is a professional legal adviser and the knowledge or suspicion or the reasonable grounds for knowing or suspecting are based on information or other matter which came to it in privileged circumstances.**

**(2) Information or other matter comes to a professional legal adviser in privileged circumstances if it is communicated or given to the adviser:**

**(a) by (or by a representative of) its client in connection with the giving by the adviser of legal advice to the client;**

**(b) by (or by a representative of) a person seeking legal advice from the adviser; or**

**(c) by a person in connection with legal proceedings or contemplated legal proceedings.**

**(3) The privileged circumstances in (2) do not apply to information or other matter which is communicated or given with a view to furthering a criminal purpose or in contravention of a provision of the regulatory system.**

...

4.3.2 R (1) A *relevant firm* must take reasonable steps to ensure that any report required by *ML 4.1.2R(1)* (Internal reporting), other than a report made to a person authorised by the Director General of NCIS, is considered by the *MLRO*, or his duly authorised delegate, and that if, having considered the report and any other relevant information, for example, *know your business information*, the *MLRO* or his duly authorised delegate:

(1) knows or suspects; or

(2) has reasonable grounds to know or suspect;

that a *person* has been engaged in *money laundering*, he reports promptly to *NCIS*.

**(2) In reporting to NCIS, an MLRO, or his duly authorised delegate, must have regard to any order under section 339 of the Proceeds of Crime Act 2002 prescribing the form and manner in which a disclosure must be made to NCIS.**

...

5.1.4 G In order to assist *relevant firms*, the Joint Money Laundering Steering Group (JMLSG) publishes government, government department, or *Financial Action Task Force* findings of the kind referred to in *ML 5.1.3R*. This information can be found on the JMLSG's website ([www.jmlsg.org.uk](http://www.jmlsg.org.uk)) or accessed indirectly via the *FSA*'s website ([www.fsa.gov.uk](http://www.fsa.gov.uk)). ~~the FSA will, from time to time, publish any government, government department or Financial Action Task Force findings, of the kind referred to in ML 5.1.3 R, on the FSA website (www.fsa.gov.uk).~~ All *relevant firms* should check this information regularly to ensure that they keep up to date with current findings.

...

6.2.1 R A *relevant firm* must take reasonable steps to ensure that staff who handle, or are managerially responsible for the handling of, *transactions* which may involve *money laundering* are aware of:

(1) their responsibilities under the *relevant firm's* arrangements made under this sourcebook, including those for obtaining sufficient evidence of identity, recognising and reporting knowledge or suspicion of *money laundering* and use of findings of material deficiencies;

(2) the identity and responsibilities of the *MLRO* or a person authorised by the Director General of NCIS;

- (3) the law relating to *money laundering*, including the *Money Laundering Regulations* and this sourcebook; and
- (4) the potential effect, on the *relevant firm*, on its *employees* and its *clients*, of any breach of that law.

...

**MLRO as “~~appropriate person~~” “nominated officer” under Money Laundering Regulations**

7.1.4 G If convenient, a *relevant firm* may decide that the same *person* can carry out the responsibilities of the *MLRO* and of the “~~appropriate person~~” “nominated officer” under the *Money Laundering Regulations*.  
“~~Appropriate person~~” “Nominated officer”, under those Regulations, means a *person* appointed to handle the internal and external reporting required by the Regulations (see Regulation 14) has the meaning given by Regulation 7.

7.1.11 R A *relevant firm* must make its *MLRO* responsible for:

...

- (3) **making external reports to NCIS under ML 4.2 4.3 (External reporting)**;

...

7.2.1 G SYSC 3.2.6 R (Compliance) requires a *relevant firm* to take reasonable care to establish and maintain appropriate systems and controls for compliance with its regulatory obligations and to counter the risk that it might be used to further *financial crime*. This section amplifies this requirement, although, for the avoidance of doubt the requirement is to take into account the whole of the ML sourcebook.

7.3.2 R (1) A *relevant firm* must make and retain, for the periods specified in (2), the following records:

...

- ~~(e) when a *relevant firm’s client* has become *insolvent*, and it has taken steps to recover all or part of a debt owed to it by the *client*, a record of the grounds and those steps; [deleted]~~

...

- (2) The specified periods are:

...

- (b) in relation to *transactions* within (1)(b), five years from the date when the *transaction* was completed; and

- ~~(e) in relation to (1)(e), five years from the date of the *insolvency*; and~~

[deleted]

...

## Part B: Proposed changes to the Statements of Principle and Code of Practice for Approved Persons (APER)

- 4.7.9 E In the case of the *Money Laundering Reporting Officer*, failing to discharge the responsibilities imposed on him in accordance with chapter 87 of the *Money Laundering* sourcebook (*ML*) falls within *APER* 4.7.2E.

## Part C: Proposed changes to the Senior Management Arrangements, Systems and Controls (SYSC)

- 3.2.7 G (3) ~~The FSA's detailed requirements for systems and controls with respect to money laundering are set out in the Money Laundering sourcebook (ML). Further rules and guidance on systems and controls with respect to money laundering are set out in the Money Laundering sourcebook (ML).~~

## Part D: Proposed changes to the Credit Unions sourcebook (CRED)

- 12.3.6 G *ML* 3.2 sets out a number of exceptions to the requirement upon *firms* to establish the identity of the *client*. These exceptions apply in principle to *credit unions*, but the only one which is likely to be relevant to the *credit union* context is that described in *ML* 3.2.4R. That rule establishes that the identification requirements need not apply if the source of funding of a *transaction* is an account held by a *client* with a *firm* which itself is subject to the requirements laid down in *ML*. In the *credit union* context this, for example, would mean that funds arriving in a member's account which originated from an account held with a *bank* or *building society* need not be subject to the *customer* identification requirements set out in *ML* 3.1.3R. However, none of these exceptions applies if the *firm* has reasonable cause to know or suspects that the *client* is engaged in *money laundering*.

...

- 12.4.1 G *Firms* should take reasonable steps to ensure that, when any report of money laundering is suspected, a report is swiftly made to the MLRO ~~reported to the MLRO is swiftly consulted~~. Having ~~consulted~~ considered the information available, if the *MLRO* suspects a *person* has been engaged in *money laundering*, he should report promptly to the National Criminal Intelligence Service (*NCIS*).

...

- 12.5.1 G *ML 5.1.2R* requires *relevant firms* to take reasonable steps to ensure that they obtain and make proper use of any government or *Financial Action Task Force* findings. In order to assist *relevant firms*, the Joint Money Laundering Steering Group (JMLSG) publishes government, government department or *Financial Action Task Force* findings, of the kind referred to in *ML 5.1.3R*. This information can be found on the JMLSG's website ([www.jmlsg.org.uk](http://www.jmlsg.org.uk)) or accessed indirectly via the *FSA*'s website ([www.fsa.gov.uk](http://www.fsa.gov.uk)). All *relevant firms* should check this information regularly to ensure that they keep up to date with current findings. This information will be published on the *FSA* website. *Firms* are required to access this information.

## Part E: Proposed changes to the Glossary

*money laundering* ~~an offence which involves the concealment, acquisition or use of criminal property or facilitating its concealment, acquisition or use, as defined for the time being in:~~

- ~~(a) section 327 (Concealing etc), 328 (Arrangements) or 329 (Acquisition, use and possession) of the Proceeds of Crime Act 2002;~~
- ~~(b) section 18 (Money laundering) of the Terrorism Act 2000.~~

any act which:

- (a) constitutes an offence under section 18 (Money laundering) of the Terrorism Act 2000; or
- (b) constitutes an offence under section 327 (Concealing etc), section 328 (Arrangements) or section 329 (Acquisition, use and possession) of the Proceeds of Crime Act 2002; or
- (c) constitutes an attempt, conspiracy or incitement to commit an offence specified in paragraph (b); or
- (d) constitutes aiding, abetting, counselling or procuring the commission of an offence specified in paragraph (b); or
- (e) would constitute an offence specified in paragraph (b), (c) or (d) if done in the *United Kingdom*.

*Money Laundering Directive*

the Council Directive of 10 June 1991 on the prevention of the use of the financial system for the purpose of

money laundering (91/308/EEC) as amended by the Council Directive of 4 December 2001 (2001/97/EEC).

*Money Laundering Regulations*

the Money Laundering Regulations ~~2001~~ (SI ~~2001/3641~~) 2003 (SI ..... ) (See *ML*)



## Annex 7

### Proposed amendments to the Collective Investment Schemes sourcebook (CIS), the Conduct of Business sourcebook (COB) and the Glossary

The amendments shown below are explained in Chapter 7. Underlining indicates new text and striking-out indicates deleted text.

#### Part A: Proposed amendments to CIS

Amend the Transitional provisions table by adding the following provision:

(1)	(2) Material to which transitional provision applies	(3)	(4) Transitional Provision	(5) Transitional provisions : dates in force	(6) Handbook provision coming into force
23	<u>CIS 10.1.4G(2),</u> <u>CIS 10.3.3R(1)(a),</u> <u>CIS 10.3.4R(1)(a),</u> <u>CIS 10.3.6R(3)</u> <u>CIS 10.4.8R(1),</u> and <u>CIS</u> <u>10.4.9R(2)(a)</u>	<u>R</u> and <u>G</u>	<u>Reports for any <i>half-yearly</i></u> <u><i>accounting period</i> or <i>annual</i></u> <u><i>accounting period</i></u> <u>commencing before 1<sup>st</sup></u> <u>December 2003 can comply</u> <u>with the Statement of</u> <u>Recommended Practice,</u> <u>Financial Statements of</u> <u>authorised <i>open-ended</i></u> <u><i>investment companies,</i></u> <u>issued by the <i>FSA</i> in</u> <u>November 2000) or with the</u> <u>Statement of Recommended</u> <u>Practice, Financial</u> <u>Statements of <i>authorised</i></u> <u><i>unit trust schemes,</i> issued by</u> <u><i>IMRO</i> in January 1997.</u>	<u>From</u> <u>[1</u> <u>February</u> <u>2004]</u> <u>for</u> <u>[12</u> <u>months]</u>	<u>From</u> <u><i>commence</i></u> <u><i>ment</i></u> <u>but</u> <u>amended</u> <u>as at [1</u> <u>February</u> <u>2004]</u>

Amend CIS 10.1.4G(2) as indicated:

**Contents of this chapter**

- 10.1.4 G (2) This chapter requires the accounts contained in the annual and half-yearly reports to comply with the *IMA SORP. Statement of Recommended Practice, Financial Statements of Authorised ~~open-ended investment companies~~*, issued by the *FSA* in November 2000 (“SORP relating to Authorised ~~open-ended investment companies~~”?) (for a report on an *ICVC*) or with the Statement of Recommended Practice, Financial Statements of *Authorised unit trust schemes*, issued by *IMRO* in January 1997 (“SORP relating to *Authorised unit trust schemes*”?) (for a report on an *AUT*).

Amend CIS 10.3.3R(1)(a) as indicated:

**Annual reports**

- 10.3.3 R (1) An annual report on an *authorised fund* other than an *umbrella scheme* must contain:
- (a) full accounts for the *annual accounting period* which must, subject to the *rules* in this chapter, include all the matters required to be included in them by the *IMA SORP. Statement of Recommended Practice relating to Authorised ~~open-ended investment companies~~* or by the *Statement of Recommended Practice relating to ~~authorised unit trust schemes~~*. Accordingly, references to those accounts (and to short form accounts mentioned in *CIS 10.3.6R*) are not to be construed to relate only to the balance sheet and the statement of total return;

Amend CIS 10.3.4R(1)(a) as indicated:

**Half-yearly reports**

- 10.3.4 R (1) A half yearly report on an *authorised fund*, other than an *umbrella scheme* must contain:
- (a) full accounts for the *half-yearly accounting period* which must, subject to the *rules* in this chapter, consist of the matters required by the *IMA SORP Statement of Recommended Practice relating to Authorised ~~open-ended investment companies~~* or by the *Statement of Recommended Practice relating to ~~Authorised unit trust schemes~~* ; and

Amend CIS 10.3.6R(3) as indicated:

**Short form accounts in reports**

- 10.3.6 R (3) Short-form accounts must comply with the relevant requirements of the *IMA SORP*. ~~Statement of Recommended Practice mentioned in CIS 10.3.3R(1)(a).~~

Amend CIS 10.4.8R(1) as indicated:

**Report of the auditor**

- 10.4.8 R The report of the auditor to the *holders* on the accounts of the *authorised fund*, or on the aggregated accounts of the *umbrella scheme* (or for a report prepared for the purposes of CIS 10.3.3R(3), on the accounts of the *sub-fund*) must state:
- (1) whether, in the auditor's opinion, the accounts have been properly prepared in accordance with the *IMA SORP* ~~Statement of Recommended Practice relating to Authorised open-ended investment companies, or the Statement of Recommended Practice relating to authorised unit trust schemes~~, the *rules* in this sourcebook, and the *instrument constituting the scheme*;

Amend CIS 10.4.9R(2)(a) as indicated:

**Auditor's statement relating to short form accounts**

- 10.4.9 R In relation to short-form accounts for any *annual accounting period*, the auditor must state whether, in the auditor's opinion, the short-form accounts are:
- (2) prepared in accordance with;
- (a) ~~the *IMA SORP* Statement of Recommended Practice relating to Authorised open-ended investment companies or in accordance with the Statement of Recommended Practice relating to authorised unit trust schemes~~ so far as they ~~it~~ relates to short-form accounts; and

## Part B: Consequential amendment to COB

Amend COB 6.6.65G(2) as indicated:

### **Changes and disclosure for authorised ~~unit trusts~~ funds**

- 6.6.65 G (2) Those expenses that were, or would be, reported in the Annual report and Financial Statements of *authorised funds ~~unit trust schemes~~* in accordance with the *IMA SORP* 'Statement of Recommended Practice' (SORP) issued by the FSA, will normally provide a suitable starting point for any assessment of the level of charges and expenses. The same principles apply to funds and *schemes* which are not within the scope of the *IMA SORP*.

## Part C: Amendment to the Glossary:

Add the following definition:

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

## Annex 8

### Proposed amendments to the Decision making manual (DEC) and the Enforcement manual (ENF)

The amendments outlined below are explained in Chapter 8. In the text, underlining indicates new text and striking through indicates deleted text.

#### Part A: Proposed amendments to Appendix 1 of DEC

##### Settlement procedure and mediation scheme for FSA ~~disciplinary~~ enforcement cases

###### 1.1 Introduction

1.1.1 G A *person* who is or may be subject to enforcement action may discuss the proposed action with *FSA* staff through settlement discussions. Settlement discussions may take place on an informal basis at any time during the enforcement process ~~after the FSA has given a warning notice.~~ Where *FSA* staff have recommended that disciplinary action be taken against a *person*, the mediation scheme will be available to those *persons* against whom action is proposed ~~after~~ where settlement discussions are, in the opinion of either party, unlikely to lead to an agreed settlement ~~have broken down.~~ This appendix sets out the procedure for settlement and the framework of the mediation scheme.

###### 1.2 Settlement

1.2.1 G If a *person* who is or may be subject to enforcement action wishes to discuss the proposed action with *FSA* staff on an informal basis, he may do so at any time during the enforcement process ~~after the FSA has given the warning notice.~~ ~~The warning notice will contain details of the person to contact for these purposes. (There is no bar on discussions at an earlier stage, but they are likely to be less productive until the FSA has given the warning notice to the person concerned.)~~ The *FSA* and the *person* concerned should agree that discussions will take place on a "without prejudice" basis, and that neither party may subsequently rely on admissions or statements made in the context of the discussions, or documents recording the discussions.

...

1.2.3 G Having considered the terms of the proposed settlement, the *RDC* may ask to meet the relevant *FSA* staff or the person concerned in order to assist in its consideration of the proposed settlement. The *RDC* may:

- (1) accept the proposed settlement by issuing a *decision notice*, *second supervisory notice* or (where appropriate) *notice of discontinuance* based on the terms of the settlement; or

...

...

### 1.3 Mediation

...

- 1.3.2 G As mediation will be on a “without prejudice” basis, admissions made by the parties in the course of the mediation and documents prepared for the purposes of the mediation may not be referred to in subsequent proceedings relating to the dispute if the mediation is unsuccessful. However, if the mediation results in a proposed settlement of the dispute which is approved by the *RDC*, the terms of the proposed settlement will form the basis of a *decision notice* and subsequent *final notice* or *second supervisory notice*, or (where appropriate) *notice of discontinuance* given by the *FSA*.

...

### 1.4 Scope and availability of the mediation scheme

- 1.4.1 G Mediation will not be available in enforcement cases where the *FSA* is contemplating bringing a criminal prosecution or cases involving disciplinary action for late submission of a report to which ENF 13.5 (Financial penalties for late submission of reports) applies. ~~involving disciplinary matters and market abuse subject to the exceptions set out in DEC.~~
- 1.4.2 G Mediation will be available in all other enforcement cases falling within the scope of the *RDC*. In those cases involving allegations of unfitness and impropriety based on judgements about dishonesty or lack of integrity and the exercise of the *FSA's own initiative powers* on a variation or cancellation of permission, mediation will be available subject to the *FSA's* consent. ~~not be available in:~~
- ~~(1) cases involving allegations of a criminal offence or offences; or~~
  - ~~(2) cases involving allegations of unfitness or impropriety based on judgements about dishonesty or lack of integrity; or~~
  - ~~(3) cases involving the exercise of the *FSA's own initiative powers* on a variation of permission; or~~
  - ~~(4) cases involving disciplinary action for late submission of a report as referred to in ENF 13.5.~~
- 1.4.3 G In a *warning notice* case falling within the scope of the scheme, in each appropriate enforcement case (see DEC App 1.4.1 and DEC App 1.4.2), the mediation scheme will be available to the person against whom a warning notice is issued. The mediation scheme will be available mediation will take place where an election to mediate is made after the *warning notice* has been issued and before the *FSA* issues a *final decision notice* (the relevant *warning notice* will state the circumstances in which mediation is available for that matter under the terms of the scheme). Where an election to mediate is made before the issue of a *warning*

notice or after the issue of a *decision notice*, mediation will be available subject to the *FSA's* consent.

1.4.4 G ~~The A person is not obliged to take part in a mediation in the course of the decision making process submit his case for mediation.~~

...

## 1.6 Starting the mediation

1.6.1 G ~~The *FSA* will offer the mediation facility in all appropriate enforcement cases (see DEC App1.4.1G). If the person agrees to submit the a case is submitted to mediation, the parties will send a joint mediation notice in an agreed form to:~~

...

## 1.7 Setting up the mediation

...

### Confidentiality

1.7.8 G ...

(2) Under the mediation scheme, however, confidentiality will be limited in that:

...

(b) the terms of any settlement reached will, if approved by the *RDC* be incorporated in a *decision notice* and subsequent final notice or *second supervisory notice*, or (where appropriate) a *notice of discontinuance* which may be made public;

...

## 1.10 Result of the mediation

...

1.10.2 G If no agreed proposal is reached, the mediation will be terminated and the case will return to the decision making process ~~proceed to the *decision notice* or stage.~~

1.10.3 G If a settlement proposal is agreed, it will be considered by the *RDC*, which will decide whether to approve it. If it is approved, a decision notice and subsequently a final notice, or second supervisory notice, will be issued reflecting the terms of the agreement reached. If it is not approved, the parties may return to the mediation only with the *RDC's* consent. If the *RDC* does not consent, the case will return to the decision making process ~~continue towards the *decision notice* stage.~~

1.10.4 G A person may elect to mediate only once during the course of the decision making process.

...

## 1.12 Review of mediation procedure

- 1.12.1 G ~~The use of mediation in the disciplinary context is a novel approach in the area of financial regulation, but reflects current trends in civil litigation.~~ The mediation provider will administer the mediation scheme and the *FSA* ~~proposes to operate the mediation scheme on a pilot basis for one year and~~ will monitor it and review its operation at the end of each year that period. The *FSA* proposes to publish core information relating to the operation of the scheme in the *FSA's* Annual Report.

## Part B: Consequential amendments to DEC

### DEC 2 Annex 5G

...

The FSA operates a mediation scheme for certain disciplinary and market abuse cases, where settlement discussions have taken place but are, in the opinion of either party, unlikely to lead to an agreed settlement ~~broken down~~.

...

## Part C: Consequential amendments to ENF

### Amendments to ENF 1.3

## 1.3 The FSA's approach to enforcement

- 1.3.1 G There are a number of principles underlying the *FSA's* approach to the exercise of its enforcement powers:

...

- (3) the FSA will seek to ensure fair treatment when exercising its enforcement powers. For example, the FSA's decision making process for regulatory enforcement cases generally gives an opportunity for both written and oral representations to be made, and also provides a facility for mediation (where settlement discussions are unlikely to lead to an agreed settlement ~~break down~~) in certain disciplinary cases.

## Annex 9

### Proposed amendments to the Complaints sourcebook (DISP) and the Compensation sourcebook (COMP)

The amendments shown below are explained in Chapter 9. Underlining indicates new text and striking-out indicates deleted text.

#### Part A: Proposed amendments to DISP

##### Exemption

- 1.1.7 R (1) A *firm* which does not conduct business with *eligible complainants* and has no reasonable likelihood of doing so is exempt from *DISP* 1.2 - *DISP* 1.7, if:
- (a) it has notified notifies the *FSA* in writing ~~of this fact and that notice remains current~~ that those conditions apply with effect from the date that notice is received by the *FSA*; and
- (b) the conditions in fact continue to apply.
- (2) The exemption takes effect from the date on which the notice was received by the *FSA*.
- (~~3~~2) In (1), conducting business means carrying on any of the activities to which the rules in *DISP* 2.6 apply with or for *persons* who are *eligible complainants* under *DISP* 2.4.
- ...
- 1.1.8 R [deleted] A notice under *DISP* 1.1.7 R ~~must be given:~~
- (1) ~~by 28 February 2002, in which case it will remain current until 31 March 2003; or~~
- (2) ~~before, or as soon as practicable after, the time of the *firm's* authorisation by the *FSA*, in which case it will remain current until the end of the *financial year* in which it is given; or~~
- (3) ~~as soon as practicable after the *firm* ceases to conduct business with *eligible complainants*, in which case it will remain current until the end of the *financial year* in which it is given; or~~
- (4) ~~in February of each *financial year* (beginning with February 2003), in which case it will remain current until the end of the next *financial year*.~~

1.1.9 G ~~[deleted] A notice under DISP 1.1.7 R will be renewable every 12 months.~~

### End of exemption

1.1.10 R *A firm which is exempt under DISP 1.1.7 R must notify the FSA in writing as soon as reasonably practicable if the conditions in DISP 1.1.7 R no longer apply.*

## Schedule 2 Notification Requirements

### 2 Table

Handbook reference	Matter to be Notified	Contents of notification	Trigger event	Time allowed
DISP 1.1.7R	Firm qualifies for exemption	Confirmation that a firm does not do business with eligible complainants and has no reasonable likelihood of doing so	<del>If the firm wishes to take advantage of the exemption in DISP 1.1.7R an annual renewal is required. See DISP 1.1.8R for timing of notice</del> <u>Conditions in DISP 1.1.7R apply</u>	N/A
DISP 1.1.10R	End of exemption	Confirmation that the conditions in DISP 1.1.7R no longer apply	Conditions in DISP 1.1.7R no longer apply	<del>Not specified</del> <u>As soon as reasonably practicable</u>

## Part B: Proposed amendments to COMP

### 13.3 Exemption

13.3.1 R **(1)** *A participant firm which does not conduct business that could give rise to a **protected claim** by an **eligible claimant** and has no reasonable likelihood of doing so is exempt from a **specific costs levy**, or a **compensation costs levy**, or both, provided that **;***

(a) it has notified~~notifies~~ the *FSCS* in writing of this fact that those conditions apply; and

(b) the conditions in fact continue to apply.~~notice remains current.~~

(2) The exemption takes effect from the date on which the notice was received by the *FSCS*, subject to *COMP* 13.3.6 R.

13.3.2 R ~~[deleted] A notice under *COMP* 13.3.1 R must be given:~~

~~(1) by 28 February 2002, in which case it will remain current until 31 March 2003; or~~

~~(2) as soon as practicable after the time of its *firm's* authorisation by the *FS1*, in which case it will remain current until the end of the financial year of the *compensation scheme* in which it is given; or~~

~~(3) as soon as practicable after it ceases to conduct business that could give rise to a *protected claim* by an *eligible claimant*, in which case it will remain current until the end of the financial year of the *compensation scheme* in which it is given; or~~

~~(4) unless (1) applies, in February of each financial year of the *compensation scheme*, in which case the notice will remain current until the end of the next financial year.~~

13.3.3 G ~~[deleted] A notice under *COMP* 13.3.1 R will be renewable every 12 months.~~

13.3.4 R A *firm* which is exempt under *COMP* 13.3.1 R must notify the *FSCS* in writing as soon as reasonably practicable if the conditions in *COMP* 13.3.1 R no longer apply.

...

13.3.6 R ~~If, during the course of a financial year of the *compensation scheme*, a *participant firm* ceases to conduct business that could give rise to a *protected claim* by an *eligible claimant* and notifies the *FSCS* of this under *COMP* 13.3.1 R (1)~~13.3.2 R (3), it will be treated as a *participant firm* to which *COMP* 13.8.7R applies until the end of the financial year of the *compensation scheme* in which the notice was given.

**Schedule 2  
Notification Requirements**

**3 Table**

<b>Handbook reference</b>	<b>Matter to be Notified</b>	<b>Contents of notification</b>	<b>Trigger event</b>	<b>Time allowed</b>
...				
<b>COMP 13.3.21</b>	Right to exemption for specific costs and compensation costs levy	Notice that firm does not conduct business that could give rise to a claim on the FSCS and has no reasonable likelihood of doing so	<del>In February each year or on the occasion of the firm's authorisation or when conducting</del> <u>If it does not, or if it ceases to, conduct</u> business with persons eligible to claim on FSCS, <u>unless it has already given such notice.</u>	<del>As soon as practicable</del> <u>None specified though exemption generally only takes effect from the date of receipt of notice by FSCS</u>
<b>COMP 13.3.4</b>	Loss of right to seek exemption from specific costs and compensation costs levy	Statement that firm no longer qualifies for exemption because it carries on business with persons eligible to claim on FSCS	Firm loses the right to claim the exemption	As soon as <u>reasonably</u> practicable

## Annex 10

### Proposed amendments to the Supervision manual (SUP) and the Credit Unions sourcebook (CRED)

The amendments shown below are explained in Chapter 10. Underlining indicates new text and striking-out indicates deleted text.

#### Part A: Proposed amendments to SUP

16 Ann14(2) R Annual return (CY) for credit unions

...

Page 7 Provision for members' doubtful debt

General Balance at beginning of year  
provision

...

~~Written off during year~~ ( \_\_\_\_\_ ) 16C

...

Specific Balance at beginning of year  
provision

...

Written off during year ( \_\_\_\_\_ ) 16H

Decrease in year ( \_\_\_\_\_ ) 16J

...

Page 11 Auditor's statement

In my opinion, the information contained in the balance sheet and revenue account of the Annual Return ~~has been completely and accurately extracted from~~ is \* / is not \*# consistent with the audited accounts published in accordance with section 3A of the Friendly and Industrial and Provident Societies Act 1968.

\* delete as appropriate

# attach a statement detailing inconsistencies

...

16 Ann15(2) G Notes on completing the Annual Return (CY) for credit unions

...

Page 8 Revenue Account

...

Expenditure

4A Admin expenses This figure should include the following expenditure items as a total figure:

...

5. Legal fees

6. Depreciation

7. Other

...

Page 10 Applications

9D Rate of dividend .... If different rates are paid on different types of accounts these different rates should be shown ~~in the boxes provided.~~

...

Page 14 Provision for members' doubtful debts

General Provision

...

~~16C Written off in year~~ The ~~total amount of loans written off from the general bad debt provision during the financial.~~

...

Page 15 FIXED ASSETS

17A Opening net book value ~~cost~~ The value ~~total amount~~ of fixed assets the *credit union* had at the end of the previous financial year.

17B	Additions <u>during the year at cost</u>	The <u>value total amount</u> of fixed assets purchased during the financial year.
17C	<u>Value-Original cost of disposals during the year</u>	The <u>value total amount</u> of fixed assets sold during the financial year, <u>included within 17A shown at original cost</u> . It is shown as a negative, as it reduces the total amount of fixed assets held by the <i>credit union</i> .
17D	Opening depreciation	<u>Total value Amount</u> of depreciation at the end of the <u>previous financial year</u> .
17E	Depreciation charge in year	Total amount of depreciation charged to <u>expenditure this financial year against assets</u> .
17F	Depreciation eliminated on disposals	Total <u>value amount taken out due to disposal of depreciation associated with assets disposed of during the year</u> .
17G	<u>Closing nNet book value</u>	The <u>value total amount</u> of fixed assets held by the <i>credit union</i> at the end of the financial year. This figure is the sum total of boxes <b>17A+17B-17C-17D-17E-17F</b> and match that shown in the balance sheet at <b>1A</b> .

...

Page 24      32D    Total assets      This is the same as box **1PM** on the Balance Sheet.

...

Page 25      This statement that the information in the Annual Return (CY) is or is not consistent with ~~has been completely and accurately extracted from~~ the annual audited accounts of the *credit union* should be completed by the *credit union's* auditor (with an attached statement detailing inconsistencies if there are any). It is important to note that the *credit union* remains responsible for the completion of the Annual Return (CY).

**Part B: Proposed amendments to CRED**

4.3.68      G      The committee of management should consider the range of possible outcomes in relation to various risks. These risks are increased when a *credit union* provides ancillary services like issuing and administering means of payment and money transmission, which result, in particular, in higher liquidity and operational risks.

...

7.2.6 G (1) ...

...

(5) CRED 9.3.7R(2) applies to loans between credit unions in relation to liquidity.

...

7.2.7 G Loans between credit unions should only be arranged after careful consideration by both parties. For example:

(1) the borrower should consider the financial implications of relying on such borrowing in order to lend to members, or to finance share withdrawals; and

(2) the lender should assess the risk of late and non-repayment arising from the borrower's own liquidity and credit risks, and keep the aggregate of its loans to other credit unions to a very modest level.

Land holding

7.2.8 G A credit union may only hold land (and buildings) for the purpose of conducting its business on that land, and where it needs to do as security for loans to members (section 12 of the Credit Unions Act 1979). This means that a credit union may not acquire as an investment land (and buildings) greatly in excess of its operating requirements, with the real purpose of letting out the excess.

7.3 Borrowing and Financial risk management

Borrowing

7.3.1 R ~~{Deleted}~~ A credit union must not borrow from a natural person, except by subordinated loan qualifying as capital under CRED 8.2.1R(4).

7.3.2 G ~~{Deleted}~~ Although section 10 of the Credit Unions Act 1979 now permits a credit union to borrow money without restriction, CRED 7.3.1R imposes a limitation. Further explanation is given at CRED 7A.3.2(2)G.

Borrowing

...

7A.3 Deposits by persons too young to be members

- 7A.3.1 R **(1) A credit union must not accept deposits except:**
- (a) as shares from its members who are natural persons qualifying in accordance with CRED Ann2 Table 1G 1;**
  - (b) from natural persons too young to be members under CRED 7A.3.1R(2); or**
  - (c) as loans from persons under CRED 7.3.1R – CRED 7.3.2G.**
- (2) A credit union must not accept ~~take~~ deposits exceeding the greater of £5,000 and 1.5 per cent of the total shareholdings in the credit union from a person who is under the age at which, under section 20 of the Industrial and Provident Societies 1965, he may become a member of the credit union.**
- 7A.3.2 G (1) The effect of the general prohibition in section 19 of the Act is that no person may carry on the regulated activity of accepting deposits, unless authorised or exempt.
- (2) CRED 7.3.1R and CRED 7A.3.1R are intended to ensure that the liberalisation of credit union borrowing (CRED 7.3.2G) does not have the unintended effect of undermining the common bond concept (CRED 13 Ann1G) by allowing credit unions to operate deposit accounts for natural persons who do not qualify for membership.
- (3) Section 20 of the Industrial and Provident Societies Act 1965 provides that a person above the age of 16 may be a member of a credit union, unless its rules provide to the contrary (see CRED 13 Ann2 Table1G3.
- (4) CRED 13 Ann2G Table 1G3 gives guidance on the eligibility of natural persons too young to be members.
- (5) (a) A credit union is no longer required to:
- (i) hold such juvenile deposits in a fund apart from the general funds of the credit union; and
  - (ii) distribute all the interest earned on the fund (after deduction of expenses) to juvenile depositors.

- (b) A credit union may make a commercial judgement on the appropriate amount of interest to pay juvenile depositors.
- (c) These changes were made by amendment of section 9 of the Credit Unions Act 1979 by Order under section 428 of the Act. (The Financial Services and Markets Act 2000 (Consequential Amendments and Transitional Provisions) (Credit Unions) Order 2002 - SI 2002 No. 1501)

...

9.2.9      G      When a credit union provides ancillary services such as issuing and administering means of payment and money transmission, it should take into account the potentially greater volatility of its funds when deciding what amount and composition of liquid assets is necessary to comply with CRED 9.2.1R.

...

9.3.7      R      (1) For the purposes ...  
(2) Amounts loaned by one credit union to another must not be counted as liquid by the lender.

...

10.2.7      G      (1) To prevent conflicts of interest, a A-credit union should have clear arrangements for dealing with loans to:  
(a) officers, ~~staff~~ and other approved persons; and  
(b) people connected with them persons (for example, relatives and other close relationships) to prevent conflicts of interest.  
(2) The term "relative" is defined in section 31 of the Credit Unions Act 1979.

10.2.7A      R      A credit union must not make a loan to any person from the categories mentioned in CRED 10.2.7G on terms more favourable than those available to other members of the credit union.

...

- 10.2.11 G (1) A credit union may only make loans to:
- (a) its members who are natural persons qualifying in accordance with CRED 13 Ann2 Table 1G 1:
  - (b) other credit unions.
- (2) A credit union may make a loan to a member for a business purpose. However, this does not mean that the credit union may make a loan to a member who merely intends to transmit that loan to another body that will actually carry out the purpose. A credit union should not make loans to members who are acting together to achieve an aggregate loan that exceeds the limits in CRED 10.3.

### 10.3 Lending limits

10.3.1 R **Subject to CRED 10.3.6R, a A-version 1 credit union ...**

...

10.3.3 R **Subject to CRED 10.3.6R, a A-version 2 credit union...**

...

**10.3.6 R A credit union with permission for entering into a regulated mortgage contract must not enter into such a contract for a term of more than 25 years.**

...

13.1.1 G This chapter applies to:

- (1) ~~[Deleted]~~ a person considering applying to the FSA for approval of the use in a name of the words "credit union" or "undeb credyd";

...

### 13.2A Use of name “credit union”

13.2A.1 G Section 3 of the Credit Unions Act 1979 (as amended) makes the following provisions about the use of the name "credit union":

- (1) under section 3(1), every credit union with its registered office:
- (a) in England or Scotland should have "credit union" in its name;

- (b) in Wales should have "credit union" or "undeb credyd" in its name;
  - (2) under section 3(2), unless one is registered as a credit union, it is an offence to:
    - (a) refer to oneself as a "credit union" or "undeb credyd", or any related words;
    - (b) represent oneself as being a credit union;

subject to section 3(3) (see CRED 13.2AG(3)).
  - (3) section 3(3) provides that section 3(2) (see CRED 13.2A.1G(2)) does not apply:
    - (a) to specified overseas deposit-takers;
    - (b) to a person who has the FSA's written approval;
    - (c) where an officer or employee uses a title or descriptive expression indicating his office or post with:
      - (i) a credit union; or
      - (ii) an organisation in CRED 13.2AG(3)(a) or (b).
- 13.2A.2 G The effect of section 3 of the Credit Unions Act 1979 (see CRED 13.2A.1G) is that if one of the following organisations, for example, wishes to use the words "credit union" in its name, it will need the approval in writing of the FSA:
- (1) a study group working towards registration as a credit union;
  - (2) a body representing or providing services to credit unions.
- 13.2A.3 G Approval for study groups (CRED 13.2A.2G(1)) will generally be limited to a period of no more than 2 years.
- 13.2A.4 G The organisations in CRED 13.2A.2G are subject to the general prohibition mentioned in CRED 7A.3.2G(1), which means that they cannot accept deposits.
- ...
- 13.4.1 G (1) For registration, applicants must...  
 .... CRED 13 Ann 1G contains a table listing these statutory

conditions.

- (a) One of the conditions is that the objects of the credit union are those, and only those, of a credit union. The objects are set out in full in the table. Unless an activity is within these objects, a credit union has no power to engage in it. It is important that a credit union satisfies itself that it has the necessary power before engaging in the activity. For instance, it is clear that a credit union does not have the power to run a lottery. However, a credit union is permitted to receive donations from an outside organisation, so may receive the proceeds from a lottery run by that organisation. Any such organisation will need to be independent from the credit union, with separate management and accounting.
- (b) Another condition is that admission to membership of the credit union is restricted to persons who fulfil an appropriate membership qualification ("AMQ") and that in consequence a common bond exists among the members.

(2) The application pack contains the relevant forms for registration and explanatory notes on how to complete the forms. The notes also contain information about the appropriate membership qualifications for credit unions.

(3) *CRED* 13 Ann 2G contains ...

...

13 Ann 1 G Requirements of Registration

1 G Table The requirements ...

**REQUIREMENT**

**SECTION OF THE RELEVANT ACTS**

That the ~~purposes~~ objects of the society are those, and only those of a credit union.

Credit Unions Act 1979, s.1(2)(a)

The objects of a credit union are:

...

the creation of sources of ~~credit~~ credit for the benefit of the members at a fair and

Credit Unions Act 1979, s.1(3)

reasonable rate of interest

...

the training and education of the members in the wise use of ~~money~~ money and in the management of their financial affairs

Credit Unions Act 1979, s.1(3)

That admission to membership of the society is restricted to individuals all of whom fulfil a specific qualification which is appropriate to a credit union (~~the~~ and that in consequence a "common bond" exists between members).

Credit Unions Act 1979, s.1(2)(b)

The appropriate membership qualifications ("AMQs") for a credit union are:

following a particular occupation

Credit Unions Act 1979, s.1(4)(a)

residing in a particular locality

Credit Unions Act 1979, s.1(4)(b)

being employed in a particular locality

Credit Unions Act 1979, s.1(4)(c)

being employed by a particular employer

Credit Unions Act 1979, s.1(4)(d)

being a member of a bona fide organisation or being otherwise associated with other members of the society for a purpose other than that of forming a society to be registered as a credit union

Credit Unions Act 1979, s.1(4)(e)

residing in or being employed in a particular locality

Credit Unions Act 1979, s.1(4)(f)

and such other qualifications as are for the time being approved by the FSA

Credit Unions Act 1979, s.1(4)

The following qualifications (in addition to those set out in section 1(4) of the Credit Unions Act 1979) have been approved by the FSA or its predecessor, the Registry of Friendly Societies:

...

~~any other qualifications as approved by the~~

*FSA*

...

13 Ann2 G Eligibility for membership of a credit union

...

Persons too young to be members

3. A person too young ...

...

(2) would qualify for membership (directly or indirectly) if he were old enough.

This means that in a qualification of residing in a particular locality, an eligible juvenile depositor should reside there (because indirect qualification means being a member of the same household as well as a relative of a DQM). In a qualification of being employed in a particular locality, a juvenile depositor is eligible by going to school or college there.

Note: These *deposits* are not shares and these depositors are not members.

...

Controllers and close links

14.10.13 G (1) Credit unions are subject to the requirements of the Act and SUP 11 on controllers and close links, and are bound to notify the FSA of changes. In practice, however, credit unions cannot develop such relationships, because:

(a) only individuals may be members of a credit union (section 5(1) of the Credit Unions Act 1979);

(b) every member is entitled to vote and has one vote only (section 5(9) of the Credit Unions Act 1979);

(c) the minimum number of members of a credit union is 21 (section 6(1) of the Credit Unions Act 1979) and its registration may be cancelled if membership falls below that number (section 16(1)(a)(i) of the Industrial and Provident Societies Act 1968 and section 20(1)(a) of the Credit Unions Act 1979); and

(d) a credit union may not have a subsidiary (section 26 of the Credit Unions Act 1979).

(2) Credit unions are therefore exempted from the requirement to submit annual reports of controllers and close links (SUP 16.1.1R-16.1.3R, 16.4.1G(-1) and 16.5.1G(-1)).

...

## Appendix 2

2.1 Detailed contents of CRED

2.1.1 Table

...

7 Investment and borrowing

...

7.3 Borrowing and Financial risk management

...

7.3.3~~1~~ Borrowing

...

7A Shareholding

...

7A.3 ~~Deposits by persons too young to be members~~

...

13 Registration and Authorisation

13.2 Introduction

13.2A Use of name "credit union"

...

14 Supervision

...

14.10 Reporting requirements

...

14.10.13(R)      Controllers and close links



## **Annex 11**

### **Creation of a new sourcebook – the Client Assets sourcebook – and proposed consequential amendments**

The amendments shown below in the draft Instrument are explained in Chapter 11. Underlining indicates new text and striking-out indicates deleted text.

#### **Draft Instrument**

#### **CLIENT ASSETS SOURCEBOOK INSTRUMENT 2003**

##### **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 powers);
  - (2) section 139(1) (Miscellaneous ancillary powers);
  - (3) section 156 (General supplementary powers); and
  - (4) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

##### **Commencement**

- C. This instrument comes into force on [1 January] 2004.

##### **Client Assets sourcebook and consequential amendments**

- D. The FSA makes the rules and gives the guidance set out in Annexes A to C to this instrument (CASS).
- E. The provisions of COB 9 are:
- (1) included in CASS after the provisions in Annex A, renumbered as shown in the table in Annex D; and
  - (2) amended as specified in Annex E.
- F. Other provisions in the FSA's Handbook of rules and guidance are amended in accordance with Annex F to this instrument, and the modules of the Handbook listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2):

(1)	(2)
Reader's Guide	Annex G
SYSC	Annex H
COB	Annex I
MAR	Annex J
AUTH	Annex K
SUP	Annex L
ENF	Annex M
CIS	Annex N
CRED	Annex O
ELM	Annex P
LLD	Annex Q
PROF	Annex R
EMPS	Annex S
FREN	Annex T
OMPS	Annex U
SERV	Annex V
Glossary	Annex W

### **Citation**

- G. This instrument may be cited as the Client Assets Sourcebook Instrument 2003.
- H. Annexes A to C to this instrument together with the provisions referred to in paragraph E may be cited as the Client Assets sourcebook.

[ December] 2003

By order of the Board

## Annex A

### The Client Assets sourcebook (all new text in this Annex)

## 1. Application and general provisions

### 1.1 Application and purpose

#### Application

- 1.1.1 G *CASS* applies to every *firm* (other than an *ICVC*) as specified in the remainder of this chapter.

#### Purpose

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

### 1.2 General application: who? what?

- 1.2.1 G The *rules* in *CASS* 1.2 set out the maximum scope of this sourcebook. The application of *CASS* is modified for certain activities by *CASS* 1.4. Also particular chapters or sections of *CASS* may have provisions which limit their application.
- 1.2.2 R *CASS* applies to every *firm*, except as provided for in *CASS* 1.2.3 R, with respect to the carrying on of:
- (1) all *regulated activities* except to the extent that a provision of *CASS* provides for a narrower application; and
  - (2) *unregulated activities* to the extent specified in any provision of *CASS*.
- 1.2.3 R *CASS* does not apply to:
- (1) an *ICVC*; or
  - (2) an *incoming EEA firm* with respect to its *passported activities*; or
  - (3) a *UCITS qualifier*.
- 1.2.4 R *CASS* 2, *CASS* 3 and *CASS* 4 do not apply to:
- (1) an *authorised professional firm* with respect to its *non-mainstream regulated activities*; or
  - (2) the *Society*.
- 1.2.5 R *CASS* 5 does not apply to an *authorised professional firm* with respect to its *non-mainstream regulated activities*, which are *insurance mediation activities*, if:
- (1) the *firm's DPB* has made rules which implement article 4 of the *IMD*;

- (2) **those rules have been approved by the FSA under section 332(5) of the Act; and**
- (3) **the firm is subject to the rules in the form in which they were approved.**

1.2.6 G Authorised professional firms should be aware of *PROF 5.2* (Nature of non-mainstream regulated activities).

1.2.7 G (1) The approach in *CASS* is to ensure that the *rules* in a chapter are applied to *firms* in respect of particular *regulated activities* or *unregulated activities*.

(2) The scope of the *regulated activities* to which *CASS* applies is determined by the description of the activity as it is set out in the *Regulated Activities Order*. Accordingly, a *firm* will not generally be subject to *CASS* in relation to any aspect of its business activities which fall within an exclusion found in the *Regulated Activities Order*. The definition of *designated investment business* includes, however, activities within the exclusion from *dealing in investments as principal* in article 15 of the *Regulated Activities Order* (Absence of holding out etc).

(3) *CASS 2*, *CASS 3* and *CASS 4* apply in relation to *regulated activities*, conducted by *firms*, which fall within the definition of *designated investment business*.

(4) *CASS 5* applies in relation to *regulated activities*, conducted by *firms*, which fall within the definition of *insurance mediation activities*.

**Application for private customers, intermediate customers and market counterparties**

1.2.8 G (1) *CASS* applies directly in respect of activities conducted with or for *market counterparties* as well as with or for *customers*. The term *client* refers both to *market counterparties* and to *customers*.

(2) In *CASS 2*, *CASS 3* and *CASS 4*, the term *customer* refers to *private customers* and *intermediate customers*, but not *market counterparties*. Where relevant, each of the provisions of *CASS* makes clear whether it applies to activities carried on with or for *private customers*, *intermediate customers* or both.

(3) *CASS 5* does not generally distinguish between different categories of *client*. However, the term *retail customer* is used for those to whom additional obligations are owed, rather than the term *private customer*. This is to be consistent with the *client* categories used in relation to the obligations in *ICOB* in relation to *insurance mediation activities*.

1.2.9 G *Firms* are reminded that the definition of *inter-professional business* does not include *safekeeping and administration of assets* or *agreeing to carry on that activity* – *CASS* will apply in this context (and will apply to the holding of *money* for *clients* in connection with *inter-professional business*).

### 1.3 General application: where?

- 1.3.1 G The *rules* in CASS 1.3 set out the maximum territorial scope of this sourcebook. Particular *rules* may have express territorial limitations.

#### UK establishments: general

- 1.3.2 R Except as provided for in CASS 1.2.3 R (2), CASS applies to every *firm*, in relation to *regulated activities* carried on by it from an *establishment* in the *United Kingdom*.

#### UK firms: passported activities from EEA branches

- 1.3.3 R CASS applies to every *UK firm*, other than an *insurer*, in relation to *passported activities* carried on by it from a *branch* in another *EEA State*.

### 1.4 Application: particular activities

#### Occupational pension scheme firms (OPS firms)

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

#### Stock lending activity with or for customers

- 1.4.2 G CASS 2 to CASS 4 apply in respect of any *stock lending activity* undertaken with or for a *customer* by a *firm*.

#### Corporate finance business

- 1.4.3 G CASS 2 to CASS 4 apply in respect of *corporate finance business* undertaken by a *firm*.

#### Oil market activity and energy market activity

- 1.4.4 G CASS 2 to CASS 4 apply in respect of *oil market activity* and other *energy market activity* undertaken by a *firm*.

### Appointed representatives

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

### Depositaries

- 1.4.6 R ***CASS* 4.1 to 4.4 do not apply to a *depository* when acting as such.**
- 1.4.7 R **The remainder of *CASS* applies to a *depository*, when acting as such, with the following general modifications:**
- (1) **except in *CASS* 4.5, '*client*' means '*trustee*', '*trust*' or '*collective investment scheme*' as appropriate; and**
  - (2) **in *CASS* 4.5, '*client*' means '*trustee*', '*collective investment scheme*' or '*collective investment scheme instrument*' as appropriate.**

## 1.5 Application: electronic media and e-commerce

### Application to electronic media

- 1.5.1 G *GEN 2.2.14 R* (References to writing) has the effect that electronic media may be used to make communications that are required by the *Handbook* to be "in writing" unless a contrary intention appears.
- 1.5.2 G For any electronic communication with a *customer*, a *firm* should:
- (1) have in place appropriate arrangements, including contingency plans, to ensure the secure transmission and receipt of the communication; it should also be able to verify the authenticity and integrity of the communication; the arrangements should be proportionate and take into account the different levels of risk in a *firm's* business;
  - (2) be able to demonstrate that the *customer* wishes to communicate using this form of media; and
  - (3) if entering into an agreement, make it clear to the *customer* that a contractual relationship is created that has legal consequences.
- 1.5.3 G *Firms* should note that *GEN 2.2.14 R* does not affect any other legal requirement that may apply in relation to the form or manner of executing a *document* or agreement.

#### Modification of CASS resulting from the E-Commerce Directive

- 1.5.4 G The application of *CASS* is modified as a result of the *E-Commerce Directive* and the *ECD Regulations*. These modifications apply to a *firm* which is an *electronic commerce activity provider*, that is, any *firm* which carries on an *electronic commerce activity*.
- 1.5.5 G As a result *firms* need to be aware of these modifications whenever they are providing a service which:
- (1) is normally provided for remuneration;
  - (2) is provided at a distance;
  - (3) is so provided by means of electronic equipment for the processing (including digital compression) and storage of data; and
  - (4) is so provided at the individual request of a recipient of the service.
- 1.5.6 G The modifications are of two kinds:
- (1) *ECO 1.1.6 R* modifies *CASS* so that a *firm* providing an *electronic commerce activity* from an *establishment* elsewhere in the *EEA* to a recipient who is in the *United Kingdom* (an *incoming ECA provider*) is not required to comply with any provision of *CASS*;
  - (2) *CASS* applies in the usual way to a *firm* providing an *electronic commerce activity* from an *establishment* in the *United Kingdom*, whether to a recipient in the *United Kingdom* or elsewhere in the *EEA*. *ECO 2* and *ECO 3* do not modify the application of *CASS* for those activities.

## Annex B

### [Schedules to CASS]

#### Client Assets

#### Schedule 1

#### Record keeping requirements

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

<b>Handbook reference</b>	<b>Subject of record</b>	<b>Contents of record</b>	<b>When record must be made</b>	<b>Retention period</b>
<i>CASS 2.1.9R</i>	A personal investment firm that temporarily holds a client's designated investments	Client details and any actions taken by the firm		3 years (from the making of the record)
<i>CASS 2.3.6R(1)(c)</i>	Safe custody: arrangements for clients ordinarily outside the United Kingdom	The steps taken and result under <i>CASS 2.3.6R(1)(c)</i>	On determination that client does not wish to execute agreement	3 years
<i>CASS 2.6.15R</i>	Client custody assets held or received by or on behalf of a client or which the firm has arranged for another to hold or receive	Full details	On receipt	3 years
<i>CASS 2.6.16R</i>	Safe custody investments used for stock lending activities	The identity of safe custody investments available to be lent, and those which have been lent	On receipt	3 years
<i>CASS 4.3.111R</i>	Client money	Sufficient	Maintain current	3 years

		records to show and explain firm's transactions and commitments	full details	(after records made)
<i>CASS</i> 4.4.24R(3)	Client money shortfall	Each client's entitlement to client money shortfall at the failed bank	Maintain up to date records	Until client repaid
<i>CASS</i> 4.4.25R(3)	Client money shortfall	Each client's entitlement to client money shortfall at the failed intermediate broker, settlement agent or OTC counterparty	Maintain up to date records	Until client repaid
<i>CASS</i> 4.4.31R(3)	Client money shortfall	Each client's entitlement to client money shortfall at the failed intermediate broker, settlement agent or OTC counterparty	Maintain up to date records	Until client repaid
<i>CASS</i> 4.5.5R	Adequate records and internal controls in respect of the firm's use of mandates (see <i>CASS</i> 4.5.5R(1) to (4))	Up to date list of firm's authorities, all transactions entered into, important client documents held by the firm	Maintain current full details	

**Client Assets**  
**Schedule 2**  
**Notification requirements**

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1 Table

<b>Handbook reference</b>	<b>Matter to be notified</b>	<b>Contents of notification</b>	<b>Trigger event</b>	<b>Time allowed</b>
<i>CASS</i> 2.6.14R(1)	Non-compliance with reconciliation requirements in <i>CASS</i> 2.6.2R, 2.6.4R, 2.6.6R, 2.6.8R, 2.6.10R	Reason for non-compliance	Non-compliance	immediately
<i>CASS</i> 2.6.14R(2)	Non-compliance of reconciliation requirements in <i>CASS</i> 2.6.11R	Reason for non-compliance once reconciliation carried out	Non-compliance	Immediately
<i>CASS</i> 4.3.64R	Failure of a third party with which money is held – ie: bank, intermediate broker, settlement agent or OTC counterparty or other entity with which it has placed or to which it has passed client money	Full details	When firm becomes aware of the failure of the entity	Immediately
<i>CASS</i> 4.3.64R	Failure of a third party with which money is held – ie: bank, intermediate broker, settlement agent or OTC counterparty or other entity with which it has placed or to which it has passed client money	Intentions regarding making good any shortfall that has arisen or may arise, and of the amounts involved	Failure of third party with which money is held	As soon as reasonably practical
<i>CASS</i> 4.3.87R	Daily calculation required by <i>CASS</i> 4.3.66R or <i>CASS</i> 4.3.67R	Inability to perform daily calculation	Inability to perform daily calculation	Immediately

<i>CASS</i> 4.3.88R	Daily calculation required by <i>CASS</i> 4.3.66R or <i>CASS</i> 4.3.67R	Inability to make good any shortfall identified by daily calculation	Inability to make good any shortfall identified by close of business on the day of calculation	Immediately
<i>CASS</i> 4.3.97R	Requirements detailed in <i>CASS</i> 4.3.89R, <i>CASS</i> 4.3.91R, <i>CASS</i> 4.3.92R, <i>CASS</i> 4.3.94R and <i>CASS</i> 4.3.95R.	Inability to comply with any of the requirements	Inability to comply with any of the requirements	As soon as possible
<i>CASS</i> 4.3.110R	LME bond arrangements	Issue of an individual letter of credit issued by the firm	Upon issue of an individual letter of credit under an LME bond arrangement	Immediately
<i>CASS</i> 4.4.33R (see <i>CASS</i> 4.3.64R)	Failure of a third party with which money is held – ie: bank, intermediate broker, settlement agent or OTC counterparty or other entity with which it has placed or to which it has passed client money	Full details	When the firm becomes aware of the failure of the entity	Immediately
<i>CASS</i> 4.4.33R (see <i>CASS</i> 4.3.64R)	Failure of a third party with which money is held – i.e. bank, intermediate broker, settlement agent or OTC counterparty	Intentions regarding making good any shortfall that has arisen or may arise, and of the amounts involved	Upon first delegation of regulated activity	As soon as reasonably practicable

**Client Assets**  
**Schedule 3**  
**Fees and other required payments**

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

**Client Assets**  
**Schedule 4**  
**Powers exercised**

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The following powers and related provisions in or under the *Act* have been exercised by the *FSA* to make the *rules* in *CASS*:

- 1 Section 138 (General rule-making power)
- 2 Section 139(1) (Miscellaneous ancillary matters)
- 3 Section 149 (Evidential provisions)
- 4 Section 156 (General supplementary powers)

The following powers in the *Act* have been exercised by the *FSA* to give the *guidance* in *CASS*:

- 5 Section 157(1) (Guidance)

**Client Assets**  
**Schedule 5**  
**Rights of actions for damages**

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

Table

Chapter/ Appendix	Section / Annex	Paragraph	Right of action under section 150		
			For private person?	Removed?	For other person?
All <i>rules</i> in <i>CASS</i> with the status letter “E”			No	No	No
All other <i>rules</i> in <i>CASS</i> .			Yes	No	No

**Client Assets**  
**Schedule 6**  
**Rules that can be waived**

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

## Annex C

### CASS 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
1	CASS 2 to CASS 4	R	COB TR 1 to COB TR 4 apply to provisions in CASS in the same way as they did to the equivalent provisions included in COB 9 before 1 January 2004.	Indefinite	1 January 2004
2	Every rule in the Handbook	R	If a <i>firm</i> or its auditors make reference to a provision in CASS 2 to CASS 4, as if it were the equivalent provision in COB 9 in a document, record, report or return, the FSA will take this as a reference to the provision in CASS 2 to CASS 4.	1 January 2004 for 12 months	1 January 2004
		G	As a result of 2, <i>firms</i> will not have to replace their <i>terms of business</i> or <i>client agreements</i> immediately on the introduction of CASS.		

## Annex D

### (Destination of *COB* 9 provisions)

Provision in <i>COB</i>	Description	Corresponding provision in <i>CASS</i>
9.1	Custody rules	2
9.1.1 R	Application	2.1.1 R
9.1.2 G	Application	2.1.2 G
9.1.3 R	Application	2.1.3 R
9.1.4 G	Application	2.1.4 G
9.1.5 G	Application	2.1.5 G
9.1.6 G	Application	2.1.6 G
9.1.7 G	Application	2.1.7 G
9.1.8 G	Application	2.1.8 G
9.1.9 R	Application	2.1.9 R
9.1.10 G	Application	2.1.10 G
9.1.11 R	Application	2.1.11 R
9.1.12 G	General Purpose	2.1.12 G
9.1.13 R	Delivery versus payment transactions	2.1.13 R
9.1.14 R	Delivery versus payment transactions	2.1.14 R
9.1.15 G	Modification of scope	2.1.15 G
9.1.16 R	Trustees and depositaries	2.1.16 R
9.1.17 G	Trustees and depositaries	2.1.17 G
9.1.18 R	Trustees and depositaries	2.1.18 R
9.1.19 R	Trustees and depositaries	2.1.19 R
9.1.20 G	Trustees and depositaries	2.1.20 G
9.1.21 R	Arrangers	2.1.21 R
9.1.22 R	Arrangers	2.1.22 R
9.1.23 G	Depositary receipt business	2.1.23 G
9.1.24 R	Depositary receipt business	2.1.24 R
9.1.25 R	Depositary receipt business	2.1.25 R
9.1.26 R	Depositary receipt business	2.1.26 R
9.1.27 G	Segregation: purpose	2.2.2 G

9.1.28	R	General	2.2.3	R
9.1.29	G	General	2.2.4	G
9.1.30	R	General	2.2.5	R
9.1.31	G	General	2.2.6	G
9.1.32	R	General	2.2.7	R
9.1.33	R	Affiliated companies	2.2.8	R
9.1.34	G	Registration and recording: purpose	2.2.9	G
9.1.35	R	Registration and recording: purpose	2.2.10	R
9.1.36	G	Registration and recording: purpose	2.2.11	G
9.1.37	G	Registration and recording: purpose	2.2.12	G
9.1.38	R	Registration and recording: purpose	2.2.13	R
9.1.39	G	Holding: purpose	2.2.14	G
9.1.40	R	Holding: purpose	2.2.15	R
9.1.41	G	Holding: purpose	2.2.16	G
9.1.42	R	Holding: purpose	2.2.17	R
9.1.43	R	Assessment of a custodian	2.2.18	R
9.1.44	R	Assessment of a custodian	2.2.19	R
9.1.45	G	Assessment of a custodian	2.2.20	G
9.1.46	G	Assessment of a custodian	2.2.21	G
9.1.47	G	Assessment of a custodian	2.2.22	G
9.1.48	R	Assessment of a custodian	2.2.23	R
9.1.49	R	Client agreement	2.3.2	R
9.1.50	G	Client agreement	2.3.3	G
9.1.51	R	Client agreement	2.3.4	R
9.1.52	R	Client agreement	2.3.5	R
9.1.53	R	Client agreement	2.3.6	R
9.1.54	R	Risk disclosures	2.3.7	R
9.1.55	G	Risk disclosures	2.3.8	G
9.1.56	G	Risk disclosures	2.3.9	G
9.1.57	R	Risk disclosures	2.3.10	R
9.1.58	R	Risk disclosures	2.3.11	R
9.1.59	R	Production and despatch of client statements	2.3.12	R
9.1.60	R	Production and despatch of client statements	2.3.13	R
9.1.61	R	Production and despatch of client statements	2.3.14	R

9.1.62	G	Production and despatch of client statements	2.3.15	G
9.1.63	R	Production and despatch of client statements	2.3.16	R
9.1.64	R	Content of client statements	2.3.17	R
9.1.65	R	Content of client statements	2.3.18	R
9.1.66	R	Content of client statements	2.3.19	R
9.1.67	G	Content of client statements	2.3.20	G
9.1.68	R	Content of client statements	2.3.21	R
9.1.69	R	Custodian agreement	2.4.2	R
9.1.70	G	Custodian agreement	2.4.3	G
9.1.71	G	Custodian agreement	2.4.4	G
9.1.72	R	Use of a safe custody investment: by the firm	2.5.2	R
9.1.73	R	Use of a safe custody investment: by another client	2.5.3	R
9.1.74	R	Stock lending	2.5.4	R
9.1.75	E	Stock lending	2.5.5	E
9.1.76	G	Stock lending	2.5.6	G
9.1.77	G	Stock lending	2.5.7	G
9.1.78	R	Stock lending	2.5.8	R
9.1.79	R	Stock lending	2.5.9	R
9.1.80	R	Stock lending	2.5.10	R
9.1.81	G	Stock lending	2.5.11	G
9.1.82	G	Stock lending	2.5.12	G
9.1.83	G	Stock lending	2.5.13	G
9.1.84	G	Stock lending	2.5.14	G
9.1.85	R	Reconciliation: frequency of reconciliation	2.6.2	R
9.1.86	G	Reconciliation: frequency of reconciliation	2.6.3	G
9.1.87	R	Reconciliation: frequency of reconciliation	2.6.4	R
9.1.88	G	Reconciliation: frequency of reconciliation	2.6.5	G
9.1.89	R	Reconciliation: frequency of reconciliation	2.6.6	R
9.1.90	G	Reconciliation: frequency of reconciliation	2.6.7	G
9.1.91	R	Reconciliation: frequency of reconciliation	2.6.8	R
9.1.92	G	Reconciliation: frequency of reconciliation	2.6.9	G
9.1.93	R	Reconciliation methods	2.6.10	R
9.1.94	R	Reconciliation discrepancies	2.6.11	R

9.1.95	G	Reconciliation discrepancies	2.6.12	G
9.1.96	G	Reconciliation discrepancies	2.6.13	G
9.1.97	R	Notification requirement	2.6.14	R
9.1.98	R	Records	2.6.15	R
9.1.99	R	Records	2.6.16	R
9.2		Mandate rules	4.5	
9.2.1	R	Application	4.5.1	R
9.2.2	G	Application	4.5.2	G
9.2.3	G	Application	4.5.3	G
9.2.4	G	Purpose	4.5.4	G
9.2.5	R	General	4.5.5	R
9.3		Client money rules	4.1 to 4.3	
9.3.1	R	Application	4.1.1	R
9.3.2	R	Application	4.1.2	R
9.3.3	G	Application	4.1.3	G
9.3.4	G	Application	4.1.4	G
9.3.5	G	Application	4.1.5	G
9.3.6	G	Application	4.1.6	G
9.3.7	G	General purpose	4.1.7	G
9.3.8	G	Money that is not client money: 'opt outs' for any business (including ISD business)	4.1.8	G
9.3.9	R	Money that is not client money: 'opt outs' for any business (including ISD business)	4.1.9	R
9.3.10	G	Opt outs' for non ISD business	4.1.10	G
9.3.11	R	Opt outs' for non ISD business	4.1.11	R
9.3.12	G	Opt outs' for non ISD business	4.1.12	G
9.3.13	R	Opt outs' for non ISD business	4.1.13	R
9.3.14	G	Opt outs' for non ISD business	4.1.14	G
9.3.15	R	Money in connection with a 'delivery versus payment' transaction	4.1.15	R
9.3.16	R	Money in connection with a 'delivery versus payment' transaction	4.1.16	R
9.3.17	G	Affiliated companies	4.1.17	G
9.3.18	R	Affiliated companies	4.1.18	R
9.3.19	R	Money due and payable to the firm	4.1.19	R

9.3.20	E	Money due and payable to the firm	4.1.20	E
9.3.21	G	Money due and payable to the firm	4.1.21	G
9.3.22	G	Money due and payable to the firm	4.1.22	G
9.3.23	G	Money due and payable to the firm	4.1.23	G
9.3.24	G	Money due and payable to the firm	4.1.24	G
9.3.25	R	Solicitors	4.1.25	R
9.3.26	R	Solicitors	4.1.26	R
9.3.27	R	Trustee firms (other than trustees of unit trust schemes)	4.1.27	R
9.3.28	R	Trustee firms (other than trustees of unit trust schemes)	4.1.28	R
9.3.29	R	Trustee firms (other than trustees of unit trust schemes)	4.1.29	R
9.3.30	G	Statutory trust	4.2.2	G
9.3.31	R	Requirement	4.2.3	R
9.3.32	G	Requirement	4.2.4	G
9.3.33	G	Requirement	4.2.5	G
9.3.34	R	Requirement	4.2.6	R
9.3.35	G	Requirement	4.2.7	G
9.3.36	G	Segregation	4.3.2	G
9.3.37	R	Segregation	4.3.3	R
9.3.38	R	Segregation	4.3.4	R
9.3.39	R	Segregation	4.3.5	R
9.3.40	R	Segregation	4.3.6	R
9.3.41	G	Segregation	4.3.7	G
9.3.42	R	Payment of client money into a client bank account	4.3.8	R
9.3.43	G	Payment of client money into a client bank account	4.3.9	G
9.3.44	R	Payment of client money into a client bank account	4.3.10	R
9.3.45	R	Payment of client money into a client bank account	4.3.11	R
9.3.46	R	Payment of client money into a client bank account	4.3.12	R
9.3.47	R	Mixed remittance	4.3.13	R

9.3.48	G	Mixed remittance	4.3.14	G
9.3.49	R	Appointed representatives, field representatives and other agents	4.3.15	R
9.3.50	G	Appointed representatives, field representatives and other agents	4.3.16	G
9.3.51	R	Appointed representatives, field representatives and other agents	4.3.17	R
9.3.52	G	Appointed representatives, field representatives and other agents	4.3.18	G
9.3.53	R	Client entitlements	4.3.19	R
9.3.54	G	Client entitlements	4.3.20	G
9.3.55	R	Client entitlements	4.3.21	R
9.3.56	R	Client entitlements	4.3.22	R
9.3.57	E	Client entitlements	4.3.23	E
9.3.58	R	Money due to a client from a firm	4.3.24	R
9.3.59	G	Money due to a client from a firm	4.3.25	G
9.3.60	R	Interest	4.3.26	R
9.3.61	G	Interest	4.3.27	G
9.3.62	G	Interest	4.3.28	G
9.3.63	G	Transfer of client money to a third party	4.3.29	G
9.3.64	R	Transfer of client money to a third party	4.3.30	R
9.3.65	G	Transfer of client money to a third party	4.3.31	G
9.3.66	G	Transfer of client money to a third party	4.3.32	G
9.3.67	G	Client bank accounts	4.3.33	G
9.3.68	R	Client bank accounts	4.3.34	R
9.3.69	R	Client bank accounts	4.3.35	R
9.3.70	R	Client bank accounts	4.3.36	R
9.3.71	G	Client bank accounts	4.3.37	G
9.3.72	G	Client bank accounts	4.3.38	G
9.3.73	G	Client bank accounts	4.3.39	G
9.3.74	R	Client bank accounts	4.3.40	R
9.3.75	G	A firm's selection of a bank	4.3.41	G
9.3.76	R	A firm's selection of a bank	4.3.42	R
9.3.77	G	A firm's selection of a bank	4.3.43	G
9.3.78	G	A firm's selection of a bank	4.3.44	G

9.3.79	G	A firm's selection of a bank	4.3.45	G
9.3.80	R	Group banks	4.3.46	R
9.3.81	R	Group banks	4.3.47	R
9.3.82	R	Notification and acknowledgement of trust (banks)	4.3.48	R
9.3.83	R	Notification and acknowledgement of trust (banks)	4.3.49	R
9.3.84	R	Notification and acknowledgement of trust (banks)	4.3.50	R
9.3.85	G	Notification and acknowledgement of trust (banks)	4.3.51	G
9.3.86	R	Notification and acknowledgement of trust (exchange, clearing house, intermediate broker or OTC counterparty)	4.3.52	R
9.3.87	R	Notification and acknowledgement of trust (exchange, clearing house, intermediate broker or OTC counterparty)	4.3.53	R
9.3.88	G	Notification and acknowledgement of trust (exchange, clearing house, intermediate broker or OTC counterparty)	4.3.54	G
9.3.89	R	Notification and acknowledgement of trust (exchange, clearing house, intermediate broker or OTC counterparty)	4.3.55	R
9.3.90	R	Notification to clients: use of an approved bank outside the United Kingdom	4.3.56	R
9.3.91	G	Notification to clients: use of an approved bank outside the United Kingdom	4.3.57	G
9.3.92	G	Notification to clients: use of an approved bank outside the United Kingdom	4.3.58	G
9.3.93	R	Notification to clients: use of an approved bank outside the United Kingdom	4.3.59	R
9.3.94	G	Notification to clients: use of an approved bank outside the United Kingdom	4.3.60	G
9.3.95	R	Notification to clients: use of an intermediate broker, settlement agent or OTC counterparty outside the United Kingdom	4.3.61	R
9.3.96	G	Notification to clients: use of an intermediate broker, settlement agent or OTC counterparty outside the United Kingdom	4.3.62	G
9.3.97	R	Notification to clients: use of an intermediate broker, settlement agent or OTC counterparty	4.3.63	R

		outside the United Kingdom		
9.3.98	R	Notification to the FSA: failure of a bank, intermediate broker, settlement agent or OTC counterparty outside the United Kingdom	4.3.64	R
9.3.99	G	Client money calculation	4.3.65	G
9.3.100	R	Client money calculation	4.3.66	R
9.3.101	R	Client money calculation	4.3.67	R
9.3.102	G	Client money calculation	4.3.68	G
9.3.103	G	Client money calculation	4.3.69	G
9.3.104	G	Client money calculation	4.3.70	G
9.3.105	R	Client money requirement	4.3.71	R
9.3.106	R	General transactions	4.3.72	R
9.3.107	R	General transactions	4.3.73	R
9.3.108	R	General transactions	4.3.74	R
9.3.109	R	General transactions	4.3.75	R
9.3.110	G	General transactions	4.3.76	G
9.3.111	G	General transactions	4.3.77	G
9.3.112	G	General transactions	4.3.78	G
9.3.113	R	Equity balance	4.3.79	R
9.3.114	R	Equity balance	4.3.80	R
9.3.115	R	Margined transaction requirement	4.3.81	R
9.3.116	G	Margined transaction requirement	4.3.82	G
9.3.117	G	Margined transaction requirement	4.3.83	G
9.3.118	G	Margined transaction requirement	4.3.84	G
9.3.119	R	Reduced client money requirement option	4.3.85	R
9.3.120	G	Reduced client money requirement option	4.3.86	G
9.3.121	R	Failure to perform calculations	4.3.87	R
9.3.122	R	Failure to perform calculations	4.3.88	R
9.3.123	R	Reconciliation of client money balances: frequency of reconciliation	4.3.89	R
9.3.124	G	Reconciliation of client money balances: frequency of reconciliation	4.3.90	G
9.3.125	R	Reconciliation of client money balances: frequency of reconciliation	4.3.91	R
9.3.126	R	Reconciliation method	4.3.92	R

9.3.127	R	Reconciliation method	4.3.93	R
9.3.128	R	Reconciliation discrepancies	4.3.94	R
9.3.129	R	Reconciliation discrepancies	4.3.95	R
9.3.130	G	Reconciliation discrepancies	4.3.96	G
9.3.131	R	Reconciliation discrepancies	4.3.97	R
9.3.132	G	Discharge of fiduciary duty	4.3.98	G
9.3.133	R	Discharge of fiduciary duty	4.3.99	R
9.3.134	G	Discharge of fiduciary duty	4.3.100	G
9.3.135	R	Discharge of fiduciary duty	4.3.101	R
9.3.136	R	Discharge of fiduciary duty	4.3.102	R
9.3.137	G	Allocated but unclaimed client money	4.3.103	G
9.3.138	R	Allocated but unclaimed client money	4.3.104	R
9.3.139	E	Allocated but unclaimed client money	4.3.105	E
9.3.140	G	Allocated but unclaimed client money	4.3.106	G
9.3.141	R	CFTC part 30 exemption order	4.3.107	R
9.3.142	R	CFTC part 30 exemption order	4.3.108	R
9.3.143	R	CFTC part 30 exemption order	4.3.109	R
9.3.144	R	CFTC part 30 exemption order	4.3.110	R
9.3.145	R	Records	4.3.111	R
9.4		Collateral rules	3	
9.4.1	R	Application	3.1.1	R
9.4.2	G	Application	3.1.2	G
9.4.3	R	Application	3.1.3	R
9.4.4	G	Application	3.1.4	G
9.4.5	G	Purpose	3.1.5	G
9.4.6	G	Purpose	3.1.6	G
9.4.7	G	Purpose	3.1.7	G
9.4.8	R	Requirements	3.2.2	R
9.4.9	G	Requirements	3.2.3	G
9.4.10	G	Requirements	3.2.4	G
9.5		Client money distribution rules	4.4	
9.5.1	R	Application	4.4.1	R
9.5.2	G	Application	4.4.2	G
9.5.3	G	Purpose	4.4.3	G

9.5.4	G	Failure of the authorised firm: primary pooling event	4.4.4	G
9.5.5	R	Failure of the authorised firm: primary pooling event	4.4.5	R
9.5.6	R	Failure of the authorised firm: primary pooling event	4.4.6	R
9.5.7	R	Pooling and distribution	4.4.7	R
9.5.8	G	Pooling and distribution	4.4.8	G
9.5.9	R	Client money received after the failure of the firm	4.4.9	R
9.5.10	G	Client money received after the failure of the firm	4.4.10	G
9.5.11	R	Client money received after the failure of the firm	4.4.11	R
9.5.12	G	Client money received after the failure of the firm	4.4.12	G
9.5.13	R	Failure of a bank, intermediate broker, settlement agent or OTC counterparty: secondary pooling events	4.4.13	R
9.5.14	R	Failure of a bank, intermediate broker, settlement agent or OTC counterparty: secondary pooling events	4.4.14	R
9.5.15	R	Failure of a bank, intermediate broker, settlement agent or OTC counterparty: secondary pooling events	4.4.15	R
9.5.16	G	Failure of a bank, intermediate broker, settlement agent or OTC counterparty: secondary pooling events	4.4.16	G
9.5.17	G	Failure of a bank, intermediate broker, settlement agent or OTC counterparty: secondary pooling events	4.4.17	G
9.5.18	G	Failure of a bank	4.4.18	G
9.5.19	G	Failure of a bank	4.4.19	G
9.5.20	R	Failure of a bank: pooling	4.4.20	R
9.5.21	R	Failure of a bank: pooling	4.4.21	R
9.5.22	R	Failure of a bank: pooling	4.4.22	R
9.5.23	G	Failure of a bank: pooling	4.4.23	G
9.5.24	R	Failure of a bank: pooling	4.4.24	R
9.5.25	R	Failure of a bank: pooling	4.4.25	R

9.5.26	R	Failure of a bank: pooling	4.4.26	R
9.5.27	R	Client money received after the failure of a bank	4.4.27	R
9.5.28	R	Client money received after the failure of a bank	4.4.28	R
9.5.29	G	Client money received after the failure of a bank	4.4.29	G
9.5.30	R	Failure of an intermediate broker, settlement agent or OTC counterparty: pooling	4.4.30	R
9.5.31	R	Failure of an intermediate broker, settlement agent or OTC counterparty: pooling	4.4.31	R
9.5.32	R	Client money received after the failure of an intermediate broker, settlement agent or OTC counterparty	4.4.32	R
9.5.33	R	Notification on the failure of a bank, intermediate broker, settlement agent or OTC counterparty	4.4.33	R

## Annex E

### Amendments to Client Assets sourcebook as created by paragraphs D and E(1) of this instrument

1. References in *CASS 2* to *CASS 4* to provisions in the left hand column of the table in Annex D are replaced with references to the corresponding provisions in the right hand column of that table.

2. Before *CASS 2.2.2* insert

#### **2.2**        **Segregation, registration and recording, and holding**                  **Application**

##### **2.2.1**       **R**    **CASS 2.2 applies in accordance with CASS 2.1**

3. Before *CASS 2.3.2* insert

#### **2.3**        **Client agreement and client statements**                  **Application**

##### **2.3.1**       **R**    **CASS 2.3 applies in accordance with CASS 2.1**

4. Before *CASS 2.4.2* insert

#### **2.4**        **Custodian agreement**                  **Application**

##### **2.4.1**       **R**    **CASS 2.4 applies in accordance with CASS 2.1**

5. Before *CASS 2.5.2* insert

#### **2.5**        **Use of a safe custody investment and stock lending**                  **Application**

##### **2.5.1**       **R**    **CASS 2.5 applies in accordance with CASS 2.1**

6. Before *CASS 2.6.2* insert

#### **2.6**        **Operation**                  **Application**

##### **2.6.1**       **R**    **CASS 2.6 applies in accordance with CASS 2.1**

7. Before *CASS* 3.2.2 insert

**3.2**        **Requirements**

**Application**

**3.2.1**        **R**    ***CASS* 3.2 applies in accordance with *CASS* 3.1**

8. Before *CASS* 4.2.2 insert

**4.2**        **Statutory trust**

**Application**

**4.2.1**        **R**    ***CASS* 4.2 applies in accordance with *CASS* 4.1**

9. Before *CASS* 4.3.2 insert

**4.3**        **Segregation and operation of client money accounts**

**Application**

**4.3.1**        **R**    ***CASS* 4.3 applies in accordance with *CASS* 4.1**

## **Annex F**

### **General amendments to the Handbook consequential on the creation of *CASS***

1. References in the *Handbook* (other than those mentioned specifically elsewhere in this instrument) to provisions in the left hand column of the table in Annex D are replaced with references to the corresponding provisions in the right hand column of that table.
2. References in the *Handbook* (other than those mentioned specifically elsewhere in this instrument) to "*COB 9*" are replaced with references to "*CASS*".

## Annex G

### Amendments to the Reader's Guide

In this Annex, underlining indicates new text.

#### Contents of the Handbook

	Sourcebook or manual	Reference code
...	...	...
<b>Business standards</b>	...	...
	Conduct of business	COB
	<u>Client assets</u>	<u>CASS</u>
	...	...

## Annex H

### Amendments to the Senior management, systems and controls sourcebook - SYSC

In this Annex, underlining indicates new text and strikethrough indicates deleted text.

- 3.2.8 R (1) ...
- (2) In SYSC 3.2.8R(1) “compliance” means compliance with the *rules* in:
- (a) *COB* (Conduct of Business); ~~and~~
  - (b) *CIS* (Collective Investment Schemes); and
  - (c) *CASS* (Client Assets).

### Appendix 1

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

- 1.1.8 G Examples of how the *FSA* considers that SYSC 3 will apply in practice to an *incoming EEA firm* (see SYSC App 1.1.4G) are as follows:
- (1) ...
- (2) The Conduct of Business sourcebook applies to an *incoming EEA firm*, ~~except that *COB 9* (Client asset rules) does not apply with respect to *passport*ed activities.~~ Similarly, SYSC 3 require such a *firm*:
- (a) ...

## Annex I

### Amendments to the Conduct of business sourcebook – COB

In this Annex, underlining indicates new text and strikethrough indicates deleted text.

1.2.1 R **COB applies to every *firm*, except that:**

- (1) ~~COB 9 (Client assets) does not apply to an incoming EEA firm, other than an insurer, with respect to its passported activities;~~
- (2) ...

...

1.3.3 G (1) ...

- (2) ~~COB 9 (Client assets) also applies directly in respect of activities conducted with or for market counterparties as well as with or for customers. The terms *client* is used in that chapter to refer both to market counterparties and to customers.~~

...

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

- (1) ...
- (2) ~~safekeeping and administration of assets and agreeing to carry on that activity~~ COB 9 (Client assets) will apply in this context (and will apply to the holding of money for clients in connection with inter-professional business);
- (3) ...

...

~~UK firms: custody services from EEA branches~~

1.4.9 R ~~In addition to the situations in COB 1.4.2 R and COB 1.4.3 R, COB 9 (Client assets) applies to all UK firms, other than insurers, in relation to passported activities carried on by it from a branch in another EEA State.~~

...

1.6.2 R **Table: Stock lending activity.**

**This table belongs to COB 1.6.1 R.**

<i>COB</i>	Subject
...	...
<del>Chapter 9</del>	<u>Client assets</u>

...

**1.6.4 R Table: Corporate finance business.**

**This table belongs to COB 1.6.3 R.**

<i>COB</i>	Subject
...	...
<del>Chapter 9</del>	<del>Client assets</del>

...

**1.6.7 R Table: Provisions applied to oil market activity and energy market activity.**

**This table belongs to COB 1.6.6 R.**

<i>COB</i>	Subject
...	...
<del>Chapter 9</del>	<del>Client assets</del>

...

**1.6.9 R Table: Oil market activity and energy market activity: provisions applied to certain dealings with or through authorised persons etc.**

**This table belongs to COB 1.6.8 R.**

<i>COB</i>	Subject
...	...
<del>Chapter 9</del>	<del>Client assets</del>

...

**11.4.3 R Table: Rules applicable to depositaries**

**This table belongs to COB 11.4.1 R.**

Chapter	Description	Modifications
...		

9	Client assets	<del>COB 9.3 and COB 9.5 do not apply.</del>  <del>Except for COB 9.2, 'client' means 'trustee', 'trust' or 'collective investment scheme' as appropriate.</del>  <del>In COB 9.2, 'client' means 'trustee', 'collective investment scheme' or 'collective investment scheme instrument' as appropriate.</del>
...		

...

**12.1.14 R Table:** This table disapplies parts of *COB* to a firm when carrying on the activities to which *COB* 12.1.7 R (1) relates.

Chapter	Description	Disapplication
...		
9	Client assets	<del>COB 9 is disapplied to the Society.</del>
...		

...

## Schedule 1

### Record keeping requirements

G

1 The aim of the guidance in the following table is to give the reader a quick overall view of the relevant record keeping requirements.

2 It is not a complete statement of those requirements and should not be relied on as if it were.

3 Table

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...				

COB 9.1.9R	A personal investment firm that temporarily holds a client's designated investments	Client details and any action taken by firm		3 years (from the making of the record)
COB 9.1.53R(3)	Safe custody: arrangements for clients ordinarily resident outside the United Kingdom	The steps taken and result under COB 9.1.53R(2)	On determination that client does not wish to execute agreement	
COB 9.1.98R	Client custody assets held or received by or on behalf of a client or which the firm has arranged for another to hold or receive	Full details	On receipt	3 years
COB 9.1.99R	Safe custody investments used for stock lending activities	The identity of safe custody investments available to be lent, and those which have been lent	On receipt	3 years
COB 9.2.5R	Adequate records and internal controls in respect of the firm's use of mandates (see COB 9.2.5R(!) to (4))	Up to date list of firm's authorities; all transactions entered into; important client documents held by firm	Maintain current full details	
COB 9.3.145R	Client money	Sufficient records to show and explain firm's transactions and commitments	Maintain current full details	3 years (after records made)
COB 9.5.24R(3)	Client money shortfall	Each client's entitlement to client money shortfall at the failed bank	Maintain current full details	Until client repaid

COB 9.2.25R(3)	Client money shortfall	Each client's entitlement to client money shortfall at the failed bank	Maintain current full details	Until client repaid
COB 9.5.31R(3)	Client money shortfall	Each client's entitlement to client money shortfall at the failed intermediate broker, settlement agent or OTC counterparty	Maintain current full details	Until client repaid
...				

## Schedule 2

### Notification requirements

1 Table G

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
...				
COB 9.1.97R(1)	non-compliance with reconciliation requirements in COB 9.1.85R, 9.1.87R, 9.1.89R, 9.1.91R, 9.1.93R	reason for non-compliance	non-compliance	immediately
COB 9.1.97R(2)	non-compliance with reconciliation requirements in COB 9.1.94R	reason for non-compliance once reconciliation is carried out	non-compliance	immediately

COB 9.3.98R	failure of a third party with which money is held – ie; bank, intermediate broker, settlement agent or OTC counter-party or other entity with which it has placed or to which it has passed client money	full details	when firm becomes aware of the failure of the entity	immediately
COB 9.1.98R	failure of a third party with which money is held – ie; bank, intermediate broker, settlement agent or OTC counter-party or other entity with which it has placed or to which it has passed client money	intentions regarding making good any shortfall that has arisen or may arise, and of the amounts involved	failure of third party with which money is held	as soon as reasonably practical
COB 9.3.121R	daily calculation required by COB 9.3.100R or COB 9.3.101R	inability to perform daily calculation	inability to perform daily calculation	immediately
COB 9.3.122R	daily calculation required by COB 9.3.100R or COB 9.3.101R	inability to make good any shortfall identified by daily calculation	inability to make good any shortfall identified by close of business on the day of calculation	immediately
COB 9.3.131R	requirements detailed in COB 9.3.123R, COB 9.3.125R, COB 9.3.126R, COB 9.3.128R and COB 9.3.129R	inability to comply with any of the requirements	inability to comply with any of the requirements	as soon as possible

COB 9.3.144R	LME bond arrangement	issue of an individual letter of credit issued by the firm	upon issue of an individual letter of credit under an LME bond arrangement	immediately
COB 9.5.33R	failure of a third party with which money is held – ie; bank, intermediate broker, settlement agent or OTC counter party or other entity with which it has placed or to which it has passed client money	full details	when firm becomes aware of the failure of the entity	immediately
COB 9.5.33R	failure of a third party with which money is held – ie; bank, intermediate broker, settlement agent or OTC counterparty	intentions regarding making good any shortfall that has arisen or may arise, and of the amounts involved	failure of third party with which money is held	as soon as reasonably practicable
...				

## Schedule 4

### Powers exercised

#### 1 Table G

The following powers and related provisions in or under the *Act* have been exercised by the *FSA* to make the *rules* in *COB*:

...

Section 139(1) and (4) (Miscellaneous ancillary matters)

...

## Annex J

### Amendments to the Market conduct sourcebook - MAR

In this Annex, underlining indicates new text.

- 3.3.2 G *MAR 3* is not the only chapter of the *Handbook* that applies to *firms* doing inter-professional business. *Firms* should always consider what other parts of the *Handbook* may apply to them. A table listing the applicable *Principles* is set out in *MAR 3Ann2G*. The table also sets out the key provisions of *COB* and *CASS* that may also apply to *firms* doing *inter-professional business* but it should not be read as an exhaustive list. *Firms* should also consider the other provisions of the *Handbook* especially but not exclusively *ML* and *IPRU*.

## Annex K

### Amendments to the Authorisation manual - AUTH

In this Annex, underlining indicates new text and strikethrough indicates deleted text.

1.5.3 G As a general guide, all applicants for *Part IV permission* should be familiar with the *threshold conditions (COND)* and the *Principles for Businesses (PRIN)* in the High Level Standards part of the *Handbook*. To complete an application for *Part IV permission*, an applicant will also need to have regard to the following matters:

(1) ...

(4) Other regulatory obligations:

(a) the detailed regulatory obligations that apply to certain types of *firm* or *regulated activity* in *COB*, *CASS*, the Market Conduct Sourcebook (*MAR*) and *SUP*;

(b) ...

...

AUTH 5

Annex 3 G Application of the Handbook to Incoming EEA Firms  
2 Table G

<b>(1) Module of Handbook</b>	<b>(2) Potential application to an incoming EEA firm with respect to activities carried on from an establishment of the firm (or its appointed representative) in the United Kingdom</b>	<b>(3) Potential application to an incoming EEA firm with respect to activities carried on other than from an establishment of the firm (or its appointed representative) in the United Kingdom</b>
...		
<i>COB</i>	<del><i>COB</i> applies, except that <i>COB 9</i> (Customer assets) does not apply with respect to the firm's passported activities (<i>COB 1.2.1R(1)</i>).</del>	...
<u><i>CASS</i></u>	<u><i>CASS</i> does not apply with respect to the firm's passported activities (<i>CASS 1.2.3R(2)</i>).</u>	<u>As column (2).</u>
...		

## Annex L

### Amendments to the Supervision manual - SUP

In this Annex, underlining indicates new text and strikethrough indicates deleted text.

- 10.7.10 G Compliance in *SYSC* 3.2.8R means compliance with the *rules* in *COB*, ~~and~~ *CIS* and *CASS*. The *FSA* anticipates that some *firms* will include oversight of compliance with *PRIN*, *MAR*, and other requirements and standards, within its compliance function. These other responsibilities would not, however, be brought within the *compliance oversight function* (see also *SUP* 10.4.3G).

## Annex M

### Amendments to the Enforcement manual - ENF

In this Annex, strikethrough indicates deleted text.

- 4.5.6 G Examples of relevant requirements are the requirements contained in COB. All of the chapters of *COB* apply to *incoming EEA firms*,<sup>5</sup> except ~~*COB 9*~~ (Client asset rules).

## Annex N

### Amendments to the Collective Investment Schemes sourcebook - CIS

In this Annex, underlining indicates new text and strikethrough indicates deleted text.

1.2.19 G There are a number of other parts of the *FSA's Handbook* that are relevant to those having a responsibility in relation to *authorised funds*. These include:

- (1) *PRIN* (The Principles for Businesses);
- (2) *SYSC* (Senior management arrangements, systems and controls);
- (3) *APER* (The Statements of principle and Code of Practice for approved persons);
- (4) *COB* (The Conduct of Business sourcebook);
- (5) *SUP* (The Supervision manual); ~~and~~
- (6) *DEC* (The Decision making manual); and
- (7) *CASS* (The Client assets sourcebook).

## Annex O

### Amendments to the Credit unions sourcebook - CRED

In this Annex, underlining indicates new text.

#### Appendix 1.1

	Sourcebook or manual	Reference code
...	...	...
<b>Business standards</b>	...	...
	Conduct of business	COB
	<u>Client assets</u>	<u>CASS</u>
	...	...

## Annex P

### Amendments to the Electronic money sourcebook - ELM

In this Annex, underlining indicates new text.

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

Block	Module	Application
...	...	...
<b>Block 2 (Business standards)</b>	...	...
	Conduct of Business sourcebook ( <i>COB</i> )  <u>Client assets sourcebook (<i>CASS</i>)</u>	...  <u>Does not apply to an <i>ELMI</i> when issuing e-money.</u>  ...
	...	

## Annex Q

### Amendments to the Lloyd's sourcebook – LLD

In this Annex, underlining indicates new text and strikethrough indicates deleted text.

- 9.2.3 R The *Society* must adopt the standards of due care and diligence set out in the custody rules at ~~COB 9~~ CASS 2 in relation to the custody of assets that constitute *members'* funds.

## Annex R

### Amendments to the Professional firms sourcebook - PROF

In this Annex, underlining indicates new text.

5.3.10      G      CASS 1.2.4R(1) provides that CASS 2, CASS 3 and CASS 4 do not apply to authorised professional firms when carrying on non-mainstream regulated activities. CASS 1.2.5G further provides that if the non-mainstream regulated activities are insurance mediation activities, CASS 5 does not apply to an authorised professional firm, if the firm's designated professional body has rules applicable to the firm which implement the IMD and which are in the form approved by the FSA under section 332(5) of the Act.

## Annex S

### Amendments to the Energy market participants sourcebook - EMPS

In this Annex, underlining indicates new text.

1.2.3            G            Table    Applicability of parts of Handbook to energy market participants. This table belongs to *EMPS* 1.2.1G

	<b>Part of Handbook</b>	<b>Applicability to energy market participants</b>
...	...	...
<b>Business standards</b>	<p style="text-align: center;">...</p> <p>Conduct of Business sourcebook (<i>COB</i>)</p> <p><u>Client assets sourcebook (<i>CASS</i>)</u></p> <p style="text-align: center;">...</p>	<p style="text-align: center;">...</p> <p style="text-align: center;">...</p> <p><u>This applies.</u></p> <p style="text-align: center;">...</p>

## Annex T

### Amendments to the Friendly societies sourcebook - FREN

In this Annex, underlining indicates new text and strikethrough indicates deleted text.

1.2.2      G      Table      Parts of the Handbook applicable to small friendly societies

	<i>Part of Handbook</i>	<b>Applicability to small friendly societies</b>
...	...	...
<b>Business standards</b>	<p>...</p> <p>Conduct of Business sourcebook (<i>COB</i>)</p> <p><u>Client assets sourcebook (<i>CASS</i>)</u></p> <p>...</p>	<p>...</p> <p>(h) ...</p> <p><del>(i) <i>COB</i> 9 (Client assets) in this part sections 9.1, 9.2 and 9.4 are relevant.</del></p> <p><i>CASS</i> 2, 3 and 4.5 are relevant to small friendly societies.</p> <p>...</p>





## Annex W

### Amendments to the Glossary of definitions

Insert the following new definitions in the appropriate alphabetical position:

*CASS*                      The Client assets sourcebook.

*client asset rules*      *CASS*  
Amend the following definitions as shown (underlining indicates new text):

*collateral*                (1) ...  
  
                                  (2) (in *COB* and *CASS* ) any of the following:  
  
                                  (a) ...

*scheme*                    (1) (except in *COB*, *CASS* and *SUP*) ...  
  
                                  (2) (in *COB*, *CASS* and *SUP*) ...



## Annex 12

### Proposed amendments to the Listing Rules

The amendments outlined below are explained in Chapter 12. In the text, underlining indicates new text and striking through indicates deleted text.

#### Amend Definition as indicated:

Combined Code

~~The principles of good governance and code of best practice prepared by the Committee on Corporate Governance, chaired by Sir Ronald Hampel, published in June 1998 and appended to, but not forming part of, the listing rules~~

The code of best practice including the principles of good governance which is appended to, but does not form part of, the listing rules, and which is in force in respect of the relevant annual reporting period. The Combined Code is the Code and principles prepared by the Committee on Corporate Governance chaired by Sir Ronald Hampel and published in June 1998 until such time as it is replaced by the ‘Combined Code on Corporate Governance’ published in July 2003 by the Financial Reporting Council.

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