

Guide to the implementation of the Capital Requirements Directive for BIPRU Limited Licence Firms

Timetable Overview

From 1st January 2007, the following elements of the Capital Requirements Directive (CRD) come into force:

- the new rules for the calculation of base capital
- Fixed Overhead Requirement
- Market Risk (under Pillar I)
- changes to the definition of the trading book
- changes to consolidated supervision rules

From 1st January 2008, the rest of CRD becomes compulsory. This covers:

- the new credit risk and operational risk calculations (under Pillar I)
- Pillar II (the ICAAP risk self assessment process)
- Pillar III (Disclosure of information)

Also from the 1st January 2007, elements of the new Systems and Controls rules that relate to CRD will be incorporated into the FSA Handbook. However, the bulk of the new SYSC rules will not come fully into force until November 2007 along with MiFID. For further information on this issue, please refer to our recent guide, Organisational Systems and Controls – A common Platform for Firms, published October 2006.

Transitional Arrangements

In the period between 1st January 2007 and adoption of CRD, which must be by January 1st 2008 at the latest, transitional arrangements will be in place. These are intended to help to integrate the CRD elements that come in on 1st January 2007 with the current handbook rules in the Interim Prudential Sourcebook for Investment Businesses (IPRU), as well as moving the rules towards the new CRD rules that are in the new Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU).

The transitional arrangements can be found within FSA Policy Statement (PS) 06/6 Annex 2 (http://www.fsa.gov.uk/pubs/policy/ps06_06_annexes.pdf) and should be used when completing financial returns from January 1st 2007.

- Compliance
- Internal Audit
- Risk Management
- Corporate Governance

Visit our online bookshop or access our revolutionary on-line Money Laundering training system at www.cpaaudit.co.uk

CPA Audit is a trading name of CPA Audit LLP, a Limited Liability Partnership registered in England and Wales.
Partnership number: OC314819. Registered office: Peek House, 20 Eastcheap, London, EC3M 1AL.

Risk Calculation under CRD Pillar 1

For a BIPRU Limited Licence Firm, the Base Capital Requirement will be equal to the higher of:

- base capital resources (50K,125K,730K);
- credit risk (CR) + market risk (MR); or
- Fixed Overheads Requirement (FOR)

Credit Risk (CR) = ‘Credit Risk’ + ‘Counterparty Risk’ + ‘Concentration Risk’

Credit Risk 8% of the risk weighted exposure amounts in the non-trading book
+
the price difference on unsettled instruments in the non-trading book after due delivery date (the difference between the agreed settlement price for the debt instrument, equity, foreign currency or commodity in question and its current market value, where the difference could involve a loss for the firm multiplied by the table found at BIPRU 14.3.5)

Counterparty Risk 8% of the total risk weighted exposure amounts for Free deliveries, Financial derivative instruments, Credit derivatives, Repurchase agreements, Reverse repurchase agreements, Securities or commodities lending or borrowing transactions based on securities or commodities included in the trading book, Margin lending transactions based on securities or commodities and Long settlement transactions
+
the price difference on unsettled instruments in the trading book after due delivery date (the difference between the agreed settlement price for the debt instrument, equity, foreign currency or commodity in question and its current market value, where the difference could involve a loss for the firm multiplied by the table found at BIPRU 14.3.5)

Concentration Risk Any exposure to the same counterparty or group of connected clients which exceeds 25% of the firms capital resources as calculated according to BIPRU 10.5

Market Risk (MR) = Interest Rate PRR + Equity PRR + Commodity PRR + Foreign Currency PRR + Option PRR + Collective Investment Undertaking PRR (as set out in BIPRU 7)

Fixed Overhead Requirement (FOR) = 25% of the firms relevant fixed expenditure excluding certain expenses calculated much the same as the current Expenditure Requirement.

These new calculations should be used when completing financial returns from the date the CRD is adopted.

Pillar II (the Risk Self Assessment Process) & Pillar III (Disclosure of Information)

Both of these areas do not come into force until the CRD is fully adopted, so January 1st 2008 at the latest. Some set up work will be required in order to get firms up to speed so as to comply with their requirements.

Systems and Controls (SYSC)

The January 1st 2007 changes to the SYSC rules consist mostly of superficial changes, along with guidance, rather than rules, for risk policies relating to CRD elements such as credit and operational risk. This will not require any action until 1st November 2007 when the new MiFID related elements are moved into the handbook. Alternatively, firms may choose to adopt them early, along with the rest of CRD and MiFID, which may be anytime from 1st January 2007.

Integrated Regulatory Reporting (IRR)

From January 1st 2007, the way firm's file FSA returns will also change with a temporary form, 'FSA 009', being required in addition to the old forms during the transition period. Once firms have fully adopted the CRD, the returns may take the format of the new forms if the firm chooses to adopt them at that time. The latest adoption time for IRR is January 1st 2008. These forms will also need to be filed electronically. For further information on this issue, please refer to our recent guide to CP 06/11 – Integrated Regulatory Reporting.

Conclusion

The imminent changes for Firms are issues mainly concerning accounting data and its treatment in the financial returns.