FSA factsheet for

All firms

Financial Services Authority

Common financial resource issues

In this factsheet:

Intangible assets such as goodwill

What are goodwill assets?

Many firms that apply for authorisation have intangible assets such as goodwill on their balance sheet. Goodwill usually arises when a business buys another business or its client book and the money it pays for this firm is more than the firm's assets (eg, computers, office, chairs etc). The additional payment is for the goodwill of the business such as its client bank and the business that has already been built up.

What do I do about these assets when calculating own funds/capital resources?

When calculating your 'own funds' in relation to the financial resources requirement, any goodwill on the balance sheet must be deducted.

What about directors' loans?

The directors of the business often club together to buy the new business by using directors' loans. If they do this, there should be a credit in the applicant's bank account of the money going in from the directors **before** a debit appears for the applicant's payment for the business.

If we can identify the credits for the directors' loans (and preferably the debit as well) then – provided you confirm that the directors' loans have been subordinated in line with our requirements (see above) – this subordinated loan can be counted towards the applicant's own funds requirement in relation to the financial resources requirement.

If the goodwill has NOT been created following an actual cash payment then the firm could still have received the benefit of the client base and have created a debt (probably in the form of a directors' loan) against this benefit. If this is the case, you can still subordinate the directors' loan(s) **IF** an auditor or independent accountant provides satisfactory answers to the following questions:

1) How was the value of the goodwill arrived at?
2) Will the goodwill be accounted for in line with standard accounting practices?
3) Will the goodwill be shown in the year-end accounts?

The auditor or accountant, as an independent person, will satisfy us that the figure used for goodwill has been recorded correctly and is a reasonable figure then we can rely upon this and the applicant can subordinate any appropriate loan.

However if the firm is subject to the provisions of the GENPRU sourcebook then it is not possible to subordinate a loan unless it was created as result of an actual cash payment. Only firms which are subject to the MIPRU or IPRU-INV sourcebooks can subordinate a debt created in recognition of the transfer of goodwill into a company without a cash payment.

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Subordinated loans

What are subordinated loans?
Subordinated loans are loans made to a company which are repayable only after other debts with a higher-ranking claim have been satisfied.

Many firms use subordinated loans as a means of meeting their own funds or capital resources requirement.

However, you can only use a subordinated loan to meet the own funds requirement if it has been made in line with our requirements.

By completing the relevant standard subordinated loan form which can be found at:
www.fsa.gov.uk/pages/Library/Communication/Forms/handbook/ipru_ib.shtml
the lender and borrower are agreeing to be bound by these requirements.

What are the requirements for subordinated loans?
Our specific requirements vary depending on your firm's prudential category and both borrower and lender should ensure that they understand what they are committing themselves to be bound by and may wish to seek legal advice.

The most commonly used form is the **Form of Subordinated Loan Agreement for Personal Investment Firms**. Despite its name, this form can also be used by firms carrying on mortgage and/or insurance mediation business. The key elements of this agreement are:

(a) It must have an original maturity of at least two years; or
(b) it is subject to two years' notice of repayment;
(c) the claims of the subordinated creditors must rank behind those of all unsubordinated creditors;
(d) the only events of default must be non-payment of any interest or principal under the debt agreement or the winding up of the firm;
(e) the remedies available to the subordinated creditor if the debtor does not pay or defaults on the subordinated debt must be limited to petitioning for the winding-up of the firm or proving the debt and claiming in the liquidation of the firm;
(f) the subordinated debt must not become due and payable before its stated final maturity date except on an event of default complying with (d);
(g) the agreement and the debt are governed by the law of England and Wales, or of Scotland or or Northern Ireland;
(h) to the fullest extent permitted under the rules of the relevant jurisdiction, creditors must waive their right to set off amounts they owe the firm against subordinated amounts owed to them by the firm; and
(i) the debt must be unsecured and fully paid up.

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