12 September 2006

Your Ref: CP 06/13

ICAEW REP 53/06

Mr Rory Vaughan
Wholesale and Prudential Policy
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Dear Mr Vaughan

CP 06/13: Quarterly Consultation Paper (Number 9) – Chapter 6

The Institute of Chartered Accountants in England and Wales is the largest professional accountancy body in Europe, with over 128,000 members, including around 25,000 professionals working across the financial services sector.

We welcome the move by the Financial Services Authority to amend the rules in respect of the treatment of members' capital of Limited Liability Partnerships ('LLPs'), formalising the guidance contained in your regulatory forbearance note of earlier in this year. We support the inclusion of members' capital in the higher tier of capital, subject to it meeting certain criteria. This is an important proposal which will better reflect the economic substance of members' capital. However, the drafting of the rules makes the definition of eligible capital too restrictive. It is more restrictive than both the wording of chapter 6 and the regulatory forbearance note.

Draft rule 2.2 (2)(b)(i) only allows capital to be eligible as members capital if it may be withdrawn only (except in the event of ceasing to continue as a regulated firm) if the member "ceases to be a member and an equal amount is transferred to another such account….". This requirement makes the definition of eligible capital stricter than the definition of equity in Financial Reporting Standard 25 *Financial Instruments: Disclosure and Presentation.* The requirement is also stricter than the requirement for companies, which may reduce share capital, for example through share buy-backs or capital distributions if the directors are satisfied that the company retains sufficient capital. It is perfectly reasonable for an LLP not to replace withdrawn capital if, for example, it has a large capital surplus or intends to scale back its size.

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A requirement that members' capital repayable only be withdrawn at the discretion of the LLP should be sufficient to make it eligible capital. The LLP would still be required to comply with the prudential capital rules and therefore this amendment would include the protection that members' capital could not be withdrawn if such a withdrawal would result in a capital deficit. The draft requirement in 2.2(2)(b)(i) should be amended accordingly.

Although the initial concerns in this area were expressed in terms of LLPs brought into focus by changes to the LLP SoRP, there are similar issues in the treatment of capital for other types of partnership, including limited partnerships, general partnerships and LLPs falling under the prudential sourcebook for banks, building societies and investment firms ('BIPRU'). The general prudential sourcebook for banks, building societies, investment firms and insurers ('GENPRU') paragraph 2.2.70 should be similarly amended in respect of Partnership capital. The proposed new text in BIPRU in relation to LLPs should also reflect this.

If you would like to discuss our comments further, please do not hesitate to contact me using the numbers below.

Yours sincerely

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