

Financial Services Compensation Scheme – unincorporated associations and partnerships

October 2013



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We are asking for comments on this Consultation Paper by 30 October 2013.

You can send them to us using the form on our website at:
www.fca.org.uk/your-fca/documents/consultation-papers/cp13-11-response-form.

Alternatively, please send comments in writing to:

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It is the FCA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure.

A confidential response may be requested from us under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Tribunal.

Copies of this Consultation Paper are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FCA order line: 0845 608 2372

Abbreviations used in this paper

| | |
|---------------------|---|
| CP | Consultation Paper |
| COMP | The Compensation sourcebook of the FCA Handbook |
| DGSD | Deposit Guarantee Schemes Directive |
| FCA | Financial Conduct Authority |
| FSA | Financial Services Authority |
| FSCS | Financial Services Compensation Scheme |
| FSMA | Financial Services and Markets Act 2000 |
| ICSD | Investor Compensation Schemes Directive |
| LLP | Limited liability partnership |
| PRA | Prudential Regulation Authority |
| The 2012 Act | The Financial Services Act 2012 |

1. Overview

- 1.1 In this Consultation Paper (CP) we propose that all unincorporated associations and certain large partnerships will become eligible to claim on the Financial Services Compensation Scheme (FSCS) if an investment firm fails.
- 1.2 We are consulting on these changes to ensure our rules properly implement the Investor Compensation Schemes Directive (ICSD). The Prudential Regulation Authority (PRA) is consulting on a similar change for unincorporated associations to ensure its rules clearly implement the Deposit Guarantee Schemes Directive (DGSD).

Who does this consultation affect?

- 1.3 This consultation affects firms authorised by the FCA and in particular firms authorised to carry on investment business that contribute to FSCS levies if an investment firm is unable, or likely to be unable, to meet claims against it.

Is this of interest to consumers?

- 1.4 Our proposals affect large unincorporated associations, such as some clubs, societies and charities, and some large partnerships. These are the bodies that, subject to the outcome of this consultation, will become eligible to claim on the FSCS in relation to investment business. So our proposals will also be of interest to any organisations that represent these bodies or provide services to them.

Context

- 1.5 The proposals support our consumer protection objective as a wider group of consumers would be eligible to claim on the FSCS in relation to investment business.
- 1.6 Our and the PRA's current rules setting out who can claim on the FSCS for investment business and for deposits reflected the Financial Services Authority's understanding of the ICSD and the DGSD when the FSA made the rules in 2001 (we are one of the successor organisations to the FSA). The FSCS paid compensation relating to investment claims in line with these rules.
- 1.7 However, we have decided that the rules did not properly implement these directives so we are taking steps to address this with regard to future investment claims. The PRA is addressing the position for future deposit claims.

- 1.8** We have identified a small number of depositors that we believe were denied compensation in the past but are not aware of any investors denied compensation. The FSCS will handle any claims for redress for past deposit and investment claims on behalf of FCA. Information about what unincorporated associations and partnerships need to do in relation to any past claims they may have will be given on the FSCS's website.¹

Summary of our proposals

- 1.9** We propose to amend the rules in the Compensation sourcebook (COMP) of our Handbook to extend eligibility to claim on the FSCS for investment business in relation to future failures of investment firms to:
- all unincorporated associations, irrespective of size, and
 - certain large partnerships – the same size test for eligibility will apply to partnerships as applies to companies making investment claims on the FSCS
- 1.10** The impact of this change will be minimal.

Equality and diversity considerations

- 1.11** We have assessed the likely equality and diversity impacts of the proposals and do not think they give rise to any concerns. Some voluntary or charitable associations are unincorporated associations and so such bodies which may have previously been excluded from claiming will in future be eligible to claim for protected investment business. We would welcome any comments on this point.

Next steps

- 1.12** Our proposals concern the changes needed to ensure our rules properly implement the eligibility requirements in the ICSD. We have included some questions about this in Chapter 2. We would welcome your comments on the proposals.
- 1.13** We are consulting for four weeks because we want to make the changes as soon as possible. Please send us your comments by 30 October 2013. We will review all the responses we get by then and intend to publish feedback – including the final text of the rules on which we are now consulting in a Policy Statement – at the end of this year, or early 2014.

¹ www.fscs.org.uk

2. Proposed changes to eligibility

- 2.1** Here we explain the background to our proposals to extend the categories of claimants who are eligible to make claims on the FSCS for investment business and ask for your comments.

Background

- 2.2** The FSCS was set up under the Financial Services and Markets Act 2000 (FSMA) on 1 December 2001 as the compensation scheme for customers of authorised financial services firms that were unable, or likely to be unable, to meet claims against them. Following public consultation², the FSA made the rules that govern the protection the FSCS can provide, including rules on who is eligible to claim on the FSCS.
- 2.3** The FSA considered that FSCS compensation should be largely provided for private individuals and small businesses as out of all claimants they had the lowest levels of experience and expertise in dealing with financial services providers. They were also least able to bear a financial loss if a firm could not meet their claims. In making the rules, the FSA also took account of the need to implement the ICSD.
- 2.4** Under the FSA's rules, unincorporated associations, including unincorporated mutual associations, and partnerships are eligible to make investment claims provided they do not have net assets of more than £1.4m at the relevant time.
- 2.5** Mutual bodies that are incorporated³ and limited liability partnerships (LLPs) are eligible to claim if they do not exceed the size test for companies in the ICSD. This size test is set out in UK law in the Companies Acts⁴ and in summary means that a company is not eligible to claim on the FSCS if it exceeds two of the three following criteria⁵:
- turnover: £6.5m
 - balance sheet total: £3.26m, and
 - number of employees: 50
- 2.6** In the light of legal advice, we have decided that our rules on the eligibility of unincorporated associations and partnerships to claim on the FSCS for investment business do not properly implement the ICSD. So we are consulting on changes to our rules to correct this position.
- 2.7** We set out the relevant rules in COMP and extracts from the relevant EU directives in Annex 1.

² In CPs 5, 24 and 58.

³ Under the Companies Acts or other legislation such as the Industrial and Provident Society Acts.

⁴ Section 247 of the Companies Act 1985 and section 382 of the Companies Act 2006. The test determines whether a company's size exceeds the limit for drawing up abridged accounts.

⁵ The size test has changed a number of times when the size test in the ICSD has changed.

Our proposals

Unincorporated associations

- 2.8** The ICSD⁶ allows member states to exclude some categories of claimants from eligibility, such as Government and local authorities, large companies and professional and institutional investors. However we do not now consider that large unincorporated associations fall in any of the permitted exclusions.
- 2.9** So we propose to amend the rules in COMP to extend eligibility to claim on the FSCS for investment business in relation to future failures of investment firms to all unincorporated associations, irrespective of size.

Partnerships

- 2.10** The ICSD's permitted exclusion of large companies defines these as companies of a size that exceeds the limit for drawing up abridged accounts under the 4th Company Law Directive.⁷ In this directive⁸ the term 'companies' also covers partnerships and limited partnerships.
- 2.11** We therefore propose to amend the rules in COMP to extend eligibility to claim on the FSCS for investment business in relation to future failures of investment firms to large partnerships provided they do not exceed the size limits that apply to companies.
- 2.12** We are taking the opportunity to clarify the definitions of 'large mutual association' and 'large partnership'. The definition of large mutual association will make it clear that it covers only unincorporated ones (as incorporated ones are large companies). In the definition of large partnership, we will remove the reference to 'unincorporated association' as this is an overlap with the definition of large mutual association.

Q1: Do you agree with our proposals to extend eligibility to all unincorporated associations and to certain large partnerships?

Scope of protection

- 2.13** The ICSD requires member states' compensation schemes to provide a minimum of €20,000 compensation to each claimant for the aggregate of their claims against one firm. Schemes must provide compensation for claims to repay client money and assets held in connection with MiFID business.⁹
- 2.14** The FSCS provides compensation up to £50,000 for investment claims. In addition, the FSCS's scope is wider than the minimum required by the ICSD as the FSCS can provide compensation for all claims in connection with protected investment business including mis-selling.
- 2.15** We propose to apply the FSCS's existing compensation limit and scope for investment business to the unincorporated associations and large partnerships that will become eligible to claim on the FSCS. This ensures consistency with other investment claimants.

Q2: Do you agree with our proposals on FSCS's compensation limit and scope?

⁶ Directive 97/9/EC.

⁷ Directive 78/66/EEC.

⁸ As amended in 1990 by Directive 90/605/EEC.

⁹ MiFID is the Markets in Financial Instruments Directive (No. 2004/39/EC).

Annex 1: Extracts from FCA Handbook and from EU directives

Extracts from FCA Handbook and from EU directives

Compensation sourcebook

COMP 4.2 Who is eligible to benefit from the protection provided by the FSCS?

COMP 4.2.1

FCAPRA

Unless COMP 4.2.3 R applies, an *eligible claimant* is any *person* who at any material time:

- (1) did not come within COMP 4.2.2 R; or
- (2) did come within COMP 4.2.2 R, but satisfied the relevant exception in COMP 4.3 or COMP 4.4.

COMP 4.2.2

FCAPRA

Table COMP 4.2.2R Persons not eligible to claim unless COMP 4.3 applies (see COMP 4.2.1R)

This table belongs to COMP 4.2.1R

.....

| | |
|------|---|
| (13) | <i>Large companies or large mutual associations</i> |
| (14) | <i>Large partnerships</i> |

COMP 4.3 Exceptions: Circumstances where a person coming within COMP 4.2.2R may receive compensation

.....

Protected investment business and protected home finance mediation

COMP 4.3.7

FCA

There are no exceptions to COMP 4.2.2R for *claims* made in connection with *protected investment business* or *protected home finance mediation*.

Glossary to the FCA Handbook

large company

FCAPRA

a *body corporate* which does not qualify as a small company under section 247 of the Companies Act 1985 , or section 382 of the Companies Act 2006 as applicable.

large mutual association

FCAPRA

a mutual association or unincorporated association with net assets of more than £1.4 million (or its equivalent in any other currency at the relevant time).

large partnership

FCAPRA

a partnership or unincorporated association with net assets of more than £1.4 million (or its equivalent in any other currency at the relevant time).

Investor Compensation Schemes Directive (97/9/EC)

Article 4

.....

2. A Member State may provide that certain investors shall be excluded from cover by schemes or shall be granted a lower level of cover. Those exclusions shall be as listed in Annex I.

ANNEX I

LIST OF EXCLUSIONS REFERRED TO IN ARTICLE 4 (2)

1. Professional and institutional investors, including:

- investment firms as defined in Article 1 (2) of Directive 93/22/EEC,
- credit institutions as defined in the first indent of Article 1 of Council Directive 77/780/EEC,
- financial institutions as defined in Article 1 (6) of Council Directive 89/646/EEC,
- insurance undertakings,
- collective-investment undertakings,
- pension and retirement funds.

Other professional and institutional investors.

2. Supranational institutions, government and central administrative authorities.

3. Provincial, regional, local and municipal authorities.

4. Directors, managers and personally liable members of investment firms, persons holding 5 % or more of the capital of such investment firms, persons responsible for carrying out the statutory audits of investment firms' accounting documents and investors with similar status in other firms within the same group as such a firm.

5. Close relatives and third parties acting on behalf of the investors referred to in point 4.

6. Other firms in the same group.

7. Investors who have any responsibility for or have taken advantage of certain facts relating to an investment firm which gave rise to the firm's financial difficulties or contributed to the deterioration of its financial situation.

8. Companies which are of such a size that they are not permitted to draw up abridged balance sheets under Article 11 of the Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies (1).

Fourth Company Law Directive ([consolidated version](#))

ARTICLE 1

1. The coordination measures prescribed by this Directive shall apply to the laws, regulations and administrative provisions of the Member States relating to the following types of company:

...

- in the United Kingdom:

public companies limited by shares or by guarantee, private companies limited by shares or by guarantee.

...

The coordination measures prescribed by this Directive shall also apply to the Member States' laws, regulations and administrative provisions relating to the following types of company:

...

(I) in the United Kingdom:

partnerships, limited partnerships, unlimited companies

...

where all members having unlimited liability are companies of the types set out in the first subparagraph or companies which are not governed by the laws of a Member State but which have a legal form comparable to those referred to in [Directive 68/151/EEC](#).

This Directive shall also apply to the types of companies or firms referred to in the second subparagraph where all members having unlimited liability are themselves companies of the types set out in that or the first subparagraph.

ARTICLE 11

The Member States may permit companies which on their balance sheet dates do not exceed the limits of two of the three following criteria:

- balance sheet total: EUR 4 400 000
- net turnover: EUR 8 800 000
- average number of employees during the financial year: 50

to draw up abridged balance sheets showing only those items preceded by letters and roman numerals in Articles 9 and 10, disclosing separately the information required in brackets in D (II) under 'Assets' and C under 'Liabilities' in Article 9 and in D (II) in Article 10, but in total for each.

Annex 2: Cost benefit analysis

1. This cost benefit analysis follows the requirements set out in section 138I of the Financial Services and Markets Act 2000 (FSMA) as amended by the Financial Services Act 2012. These require the FCA to publish a cost benefit analysis of their proposed rules, unless there will be an increase in costs of minimal significance.
2. The proposals set out in this CP will extend eligibility to claim on the FSCS for investment business to:
 - unincorporated associations, irrespective of size – currently unincorporated associations are eligible provided they do not have net assets of more than £1.4 million; and
 - certain large partnerships – currently partnerships are eligible provided they do not have net assets of more than £1.4 million and we propose to extend eligibility so that partnerships will be eligible provided they do not exceed the size limits that apply to companies.¹⁰
3. We are not required to carry out a CBA to understand the implications to the FCA, firms and consumers of paying out redress in relation to past defaults as any payment does not require Handbook rule changes. Therefore the CBA below focuses on the implications of changing our Handbook rule so that all unincorporated associations and certain partnerships will be eligible to claim on the FSCS if there are future defaults of investment firms. We are required to make these changes to meet our obligations under the ICSD.

Population of unincorporated associations and partnerships

4. We consider that unincorporated associations are likely to be clubs, societies or charities. We estimate that around 5,000 clubs and societies are unincorporated associations.¹¹ This estimate is based on a number of assumptions.¹² Our expectation is that not all 5,000 of these associations will now be eligible for compensation, as many of them are small, and as such,

¹⁰ Broadly, a partnership will not be eligible to claim if it exceeds two of the following criteria: turnover £6.5m, balance sheet total £3.26m and number of employees 50.

¹¹ Mutuels Yearbook 2011 page 25.

¹² We have assumed that most bodies that are one of the following types of mutual are likely to be incorporated: cooperatives, supporters trusts in sport, housing associations, leisure trusts and NHS foundation trusts. These bodies could be incorporated under the Companies Act or as industrial and provident societies or under the Friendly Societies Act (eg working men's clubs). In addition, the Mutuels Yearbook 2011 explains that the figures in the Yearbook were collected using a variety of methods and that figures for sectors that are not regulated were based on calculations by experts (Methodology, page 47).

will already be covered by the FSCS. We have estimated that around 24,000 partnerships could become eligible claimants¹³ as a result of these changes.¹⁴

Costs

5. It is our expectation that these changes will impose incremental costs on firms, the FCA and FSCS of minimal significance. The changes mean that in the event of an investment firm failing and being unable to meet claims against it, for example claims for client money or for mis-selling, those investors that are unincorporated associations or are partnerships that fall under the size thresholds will be able to claim up to £50,000.
6. Our expectation is that the incremental increase in compensation costs as a result of an investment firm failure is likely to be small because:
 - The number of organisations who will become eligible to claim is likely to be small, so for a particular investment firm it is likely that a small proportion of their investors will become eligible to claim.
 - The size and nature of these organisations mean they are unlikely to hold significant assets as investments.
 - The FSCS has looked at a sample of investment firms that have failed since the FSCS was set up on 1 December 2001 and found no claimants that were denied compensation because they fell within the size of unincorporated associations/partnerships that now will be eligible to claim. We acknowledge that this may not give absolute comfort as there could have been some investors that did not claim when these firms failed because they knew they were not eligible and many other firms have failed since the FSCS was set up.

Benefits

7. The benefit from this rule change is the compensation that certain unincorporated associations and partnerships will now receive, in the event of an investment firm failure. This benefit is a transfer from the investment firms who pay the compensation.

Q3: Do you agree with the costs and benefits identified?

Q4: Can you provide further information on the costs and benefits?

¹³ Office for National Statistics UK Business: Activity, Size and Location 2011 www.ons.gov.uk/ons/re/business-register/uk-business/2011/sum-ukbusiness-2011.html.

¹⁴ Using ONS data, we identified the number of partnerships and assume they are distributed by size in the same way as other businesses. This means an estimated 9% of partnerships will fall within the size category that will make them eligible to claim, assuming that they are all unincorporated.

Impact on mutual societies

8. Section 138 K of FSMA requires us to provide an opinion on whether the impact of proposed rules on mutual societies is significantly different to the impact on other authorised persons.
9. The proposed rules will apply to the FSCS, rather than to authorised persons (firms). However firms will meet the cost of any additional compensation the FSCS pays in future as a result of our proposals and any additional FSCS management expenses. We do not believe that the impact of our proposals on mutual societies is significantly different to the impact on other firms.
10. This is because our rules attribute FSCS's compensation costs and management expenses to FSCS funding groups on the basis of the regulated activity that gave rise to the costs. Firms are allocated to funding groups (and meet the costs attributed to these groups) on the basis of the regulated activities they have permission to undertake, not by reference to whether the firms are mutuals.

Annex 3: Compatibility statement

Compatibility with the FCA's General Duties

1. Section 138I of FSMA requires the FCA, when consulting on new rules, to include an explanation of the FCA's reasons for believing that making the proposed rules is compatible with its strategic objective, advances one or more of its operational objectives, and has regard to the regulatory principles set out in FSMA (section 3B). In addition, the FCA must discharge its general functions in a way which promotes effective competition in the interests of consumers. This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

FCA's objectives and regulatory principles

2. The proposals set out in this consultation paper primarily advance the FCA's operational objective of 'securing an appropriate degree of protection for consumers'. We consider the proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets¹⁵ function well. The proposals will extend the categories of persons eligible to claim compensation from the FSCS if an investment firm is unable, or likely to be unable, to meet claims against it.
3. We consider that the proposals advance the FCA's operational objective of securing an appropriate degree of protection for consumers because they will ensure our rules properly implement the requirement in the ICSD that unincorporated associations and certain large partnerships are eligible for protection under the FSCS. In particular, we are not proposing to extend protection to all partnerships, only to those the ICSD requires to be protected.
4. The proposals are compatible with the duty to promote effective competition in the interests of consumers. As noted in the CBA, any levy on investment firms, as a result of the proposals, is likely to be small and will take into account the business volumes of the firms levied. Therefore the rule change is not expected to distort firms' ability or incentives to compete or to compete vigorously.
5. In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s.3B of FSMA. We set out below how our proposals demonstrate regard to the principles.

¹⁵ 'relevant markets' are defined by s.1F FSMA.

The need to use our resources in the most efficient and economic way

6. The FSCS is operationally independent, but accountable to us and to the PRA. This means that our resources are not directly involved in giving effect to our proposals. However firms will meet any additional FSCS compensation costs and management expenses. Our proposal to extend protection only to those partnerships required by the ICSD will restrict the impact on firms.

The principle that regulatory burdens and restrictions should be proportionate to the expected benefits

7. For more information, please see the CBA section (Annex 2).
8. We do not consider that the changes we are consulting on will have any significant effect on the other principles.

Annex 4: List of questions

- Q1:** Do you agree with our proposals to extend eligibility to all unincorporated associations and to certain large partnerships?
- Q2:** Do you agree with our proposals on FSCS's compensation limit and scope?
- Q3:** Do you agree with the costs and benefits identified?
- Q4:** Can you provide further information on the costs and benefits?

Appendix 1: Draft Handbook text

**COMPENSATION SOURCEBOOK (INVESTMENTS BY LARGE
UNINCORPORATED ASSOCIATIONS AND CERTAIN LARGE PARTNERSHIPS)
INSTRUMENT 2013**

Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of the powers and related provisions in:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 213 (The compensation scheme);
 - (b) section 214 (General);
 - (c) section 137T (General supplementary powers); and
 - (d) section 138A (Power to give guidance); and
 - (2) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.
- B. The rule-making powers referred to above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on [date].

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Compensation sourcebook (COMP) is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Compensation Sourcebook (Investments by Large Unincorporated Associations and Certain Large Partnerships) Instrument 2013.

By order of the Board of the Financial Conduct Authority
[date] 2013

Annex A

Amendments to the Glossary of definitions

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

- | | |
|---------------------------------|---|
| <i>large mutual association</i> | <p>(1) <u>(in COMP) an unincorporated</u> a mutual association or unincorporated association <u>(which is not a mutual association)</u> with net assets of more than £1.4 million (or its equivalent in any other currency at the relevant time).</p> <p>(2) <u>(except in COMP) a mutual association or unincorporated association with net assets of more than £1.4 million (or its equivalent in any other currency at the relevant time).</u></p> |
| <i>large partnership</i> | <p>(1) <u>(in COMP) a partnership</u> or unincorporated association with net assets of more than £1.4 million (or its equivalent in any other currency at the relevant time).</p> <p>(2) <u>(except in COMP) a partnership or unincorporated association with net assets of more than £1.4 million (or its equivalent in any other currency at the relevant time).</u></p> |

Annex B

Amendments to the Compensation sourcebook (COMP)

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

- 4.2.2 R Table : Persons not eligible to claim unless COMP 4.3 applies (see COMP 4.2.1R)

...

| | |
|-------------|--|
| ... | |
| (13) | <i>Large companies</i> or large mutual associations |
| ... | |
| <u>(19)</u> | <u>Large mutual associations</u> |

...

Protected ~~investment business and protected~~ home finance mediation

- 4.3.7 G There are no exceptions to *COMP 4.2.2R* for *claims* made in connection with ~~protected investment business or protected home finance mediation~~.

...

Protected investment business

- 4.3.9 R A person is eligible to claim compensation for *claims* made in connection with *protected investment business* if, at the date at which the *relevant person* is deemed to be in *default*, he:

- (1) came within category (14) of *COMP 4.2.2R* and he does not exceed the limits for a *body corporate* which qualifies as a small company under section 247 of the Companies Act 1985 or section 382 of the Companies Act 2006 as applicable; or
- (2) came within category (19) of *COMP 4.2.2R*.

....

TP1.1 Transitional Provisions Table

| (1) | (2) | (3) | (4) | (5) | (6) |
|-------------|---|----------|---|---|--|
| | Material to which the transitional provision applies | | Transitional Provision | Transitional provision: dates in force | Handbook Provisions: coming into force |
| ... | | | | | |
| 34 [FCA] | <u>Amendments introduced by the Compensation Sourcebook (Investments by Large Unincorporated Associations and Certain Large Partnerships) Instrument 2013</u> | <u>R</u> | <u>The changes referred to in (2) do not apply in relation to a <i>claim</i> against a <i>relevant person</i> that was <i>in default</i> before [insert commencement date of instrument].</u> | <u>From [insert commencement date of instrument] indefinitely</u> | <u>From [insert commencement date of instrument]</u> |



PUB REF: 003252

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