Section 988 Foreign Currency Transaction Reporting Rules for Options, Straddles and Hedges

THURSDAY, NOVEMBER 15, 2018, 1:00-2:50 pm Eastern

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Internal Revenue Service
DEPARTMENT OF THE TREASURY

LB&I International Practice Service Concept Unit

IPS Level	Number	Title	UIL Code	Number
Shelf	N/A	Crossover IPN	–	–
Volume	18	Foreign Currency	**Level 1 UIL**	9470
Part	18.2	Transactions in a Foreign Currency – Section 988	**Level 2 UIL**	9470.02
Chapter	18.2.1	Computation of Exchange Gain or Loss - General	**Level 3 UIL**	9470.02-01
Sub-Chapter	N/A	N/A	–	–

Unit Name	Character of Exchange Gain or Loss on Currency Transactions

Document Control Number (DCN)	FCU/CU/C-18.2.1_04(2016)
Date of Last Update	06/01/2016

Table of Contents

(View this PowerPoint in "Presentation View" to click on the links below)

General Overview

Character of Exchange Gain or Loss on Currency Transactions

The functional currency of US taxpayers is generally the US dollar. If a US taxpayer engages in a transaction denominated in nonfunctional currency, it will most likely result in a foreign currency exchange gain or loss, separate from the underlying transaction. A foreign currency exchange gain or loss is the gain or loss realized due to the change in exchange rates between the booking date and the payment date of a transaction involving an asset or liability denominated in a nonfunctional currency. The gain or loss from disposing of nonfunctional currency is determined by the change in exchange rates between the date the nonfunctional currency was acquired and the date of disposition.

Prior to the enactment of Internal Revenue Code (IRC) Section 988 under The Tax Reform Act of 1986, the treatment of foreign currency transactions was inconsistent. Determining the timing, amount, character, and source of the gains and losses that resulted from transactions in foreign currencies relied on court decisions and administrative rulings. These decisions were usually based on specific information relative to the transaction at hand.

IRC 988 provides guidelines for the treatment of certain transactions denominated in a nonfunctional currency. These transactions include the acquisition of a debt instrument, or becoming the obligor of a debt instrument, accruing (or otherwise taking into account) any item of expense or income which will be paid or received after the accrual, entering into or acquiring any forward contract, futures contract, option, or similar financial instrument, and the disposition of nonfunctional currency. Definitions of specific transactions subject to IRC 988 will be the subject of a separate IPS unit.

Under IRC 988(a)(1)(A), the foreign currency exchange gain or loss attributable to a Section 988 transaction is generally ordinary income. However, there are special rules, exceptions and elections which change the character of a Section 988 transaction; please see the Detailed Explanation of the Concept for examples of these rules, exceptions and elections. The foreign currency exchange gain or loss is separate from any gain or loss on the underlying Section 988 transaction. IRC 988 is principally a source and character provision.

While IRC 988 addresses the 1) character, 2) source, 3) timing and 4) amount of gains and losses resulting from foreign currency transactions, this IPS unit will address only the character of foreign currency exchange gain or loss resulting from a Section 988 transaction. In general, a Section 988 transaction will result in a foreign currency exchange gain or loss that is ordinary. The remaining items related to gains and losses from transactions in foreign currency will be covered in other IPS units.

Facts of Concept

Character of Exchange Gain or Loss on Currency Transactions

Facts of Concept

In general, the character of a foreign currency exchange gain or loss from any of the following Section 988 transactions, denominated in nonfunctional currency, is ordinary and is determined separately from the underlying transaction.

- The acquisition of a debt instrument or becoming the obligor under a debt instrument.
- Accruing any item of expense or gross income or receipts which will be paid or received after the accrual date.
- Entering into or acquiring any forward contract, futures contract, option or similar financial instrument.
  - There is an exception for regulated futures contract or non-equity options subject to the marked to market rules under IRC 1256. See IRC 988(c)(1)(D)(i). In the case of these contracts, the exchange gain or loss would be subject to character rules under IRC 1256(a), unless an election into the rules of IRC 988 and out of of IRC 988(c)(1)(D)(i) is made.
- The disposition of nonfunctional currency.

These transactions are identified in IRC 988(c)(1)(A), (B), and (C) and Treas. Reg. 1.988-1(a)(1) and (2)(i) – (iii).

The foreign currency exchange gain or loss is determined separately from the underlying transaction and is generally reported as ordinary gain (loss) as a result of undertaking a transaction denominated in a nonfunctional currency under IRC 988.

Although in general, the character rules of IRC 988 provide for ordinary treatment overriding the character rules of IRC 1256, in the case of regulated futures contracts or non-equity options subject to IRC 1256 marked to market rules, IRC 1256(a) character rules (40% short term capital loss and 60% long term capital loss) apply unless the taxpayer elects IRC 988 treatment.

Detailed Explanation of the Concept

Character of Exchange Gain or Loss on Currency Transactions

Debt Instruments: In general, the character of the exchange gain or loss will be ordinary. There are special netting rules that may limit the exchange gain or loss on payment or disposition of a debt instrument.

Analysis	Resources
▪ The character of the exchange gain or loss from the acquisition of a debt instrument or becoming an obligor under a debt instrument, denominated in nonfunctional currency, is generally ordinary.	▪ IRC Section 988(a)(1)(A) and IRC Section 988(c)(1)(A) and (B)(i). Treas. Reg. 1.988-1(a)(2)(i) and Treas. Reg. 1.988-3(a). BNA 921-2nd – TMFEDPORT No. 921 §III Foreign Currency Transactions C.7.e. Character of Exchange Gain or Loss with Respect to Debt Instruments. Refer to Bittker and Lokken Part 9 Chapter 74.8 Debt Instruments.
▪ The realization of an exchange gain or loss from the acquisition of a debt instrument or becoming an obligor under a debt instrument, denominated in nonfunctional currency, is subject to the netting rule. An example of the netting rule would be the taxpayer's capital loss from market fluctuations offsetting the ordinary gain that results from exchange rate fluctuations.	▪ Treas. Reg. 1.988-2(b)(8) , Limitation of exchange gain or loss on payment or disposition of a debt instrument.
▪ Thus, the sum of any exchange gain or loss with respect to the principal and interest of any such debt instrument shall be realized only to the extent of the total gain or loss realized on the transaction.	▪ BNA 921- 2nd – TMFEDPORT No. 921 §III Foreign Currency Transactions C.7.d.(1).(d) The Netting Rule for Exchange Gain or Loss on Payment or Disposition of a Debt Instrument.

Back to Table Of Contents

Detailed Explanation of the Concept (cont'd)

Character of Exchange Gain or Loss on Currency Transactions
Debt Instruments: In general, the character of the exchange gain or loss will be ordinary. There are special netting rules that may limit the exchange gain or loss on payment or disposition of a debt instrument.

Analysis	Resources
▪ Generally, an exchange gain or loss realized on a Section 988 transaction shall not be treated as interest income or expense. However, exchange gain or loss realized on a Section 988 transaction shall be treated as interest income or expense as provided in IRC 988(c)(2) with regard to tax exempt bonds.	▪ Treas. Reg. 1.988-3(c) – general rule ▪ Treas. Reg. 1.988-3(c)(2) – tax exempt bonds

Detailed Explanation of the Concept (cont'd)

Character of Exchange Gain or Loss on Currency Transactions
Payables and Receivables: In general, the character of the exchange gain or loss will be ordinary. There is an exception to the general rule for accrued foreign taxes of a QBU branch.

Analysis	Resources
▪ If the taxpayer accrues an item of expense or gross income or receipts, denominated in nonfunctional currency, which is later paid or received, the resulting exchange gain or loss is ordinary income.	▪ IRC 988(a)(1)(A) and IRC 988(c)(1)(A) and (B)(ii). ▪ Treas. Reg. 1.988-1(a)(2)(ii) and Treas. Reg. 1.988-3(a). ▪ BNA 921-2nd – TMFEPORT No. 921 §III Foreign Currency Transactions C.6. *Accounts Payable and Accounts Receivable.*
▪ There is an exception for the accrued foreign taxes of a QBU branch whose functional currency is the US dollar and the foreign taxes are claimed as a foreign tax credit under IRC 901. Such payables are not Section 988 transactions. QBU branches compute income under IRC 987.	▪ Treas. Reg. 1.988-1(a)(2)(ii)

Detailed Explanation of the Concept (cont'd)

Character of Exchange Gain or Loss on Currency Transactions

Financial Instruments: In general, the character of the exchange gain or loss will be ordinary. There are special rules and exceptions to the general rule for certain identified forward contracts, futures contracts and option contracts and also for any regulated futures contract or non-equity option which would be marked to market.

Analysis	Resources
▪ If the taxpayer enters into or acquires any forward contract, futures contract, option, or similar financial instrument, denominated in nonfunctional currency, the resulting foreign currency exchange gain or loss is ordinary.	▪ IRC 988(a)(1)(A) and IRC 988(c)(1)(A) and (B)(iii) ▪ Treas. Reg. 1.988-1(a)(2)(iii) and Treas. Reg. 1.988-3(a) ▪ BNA 921-2nd – TMFEDPORT No. 921 §III Foreign Currency Transactions C.9. Forward, Futures, Options and Similar Financial Instruments

Detailed Explanation of the Concept (cont'd)

Character of Exchange Gain or Loss on Currency Transactions

Financial Instruments: In general, the character of the exchange gain or loss will be ordinary. There are special rules and exceptions to the general rule for certain identified forward contracts, futures contracts and option contracts and also for any regulated futures contract or non-equity option which would be marked to market.

Analysis	Resources
▪ There is a special rule in which the taxpayer can elect to characterize the exchange gain or loss on certain identified forward contracts, futures contracts, and option contracts as capital gain or loss but only if the contract is a capital asset , not part of a straddle and not a regulated futures contract or nonequity option with respect to which an election under section 988(c)(1)(D)(ii) is in effect (see above). If this election is made with respect to a section 1256 contract, section 1256 shall govern the character of any gain or loss recognized on such contract. ▪ If a contract which is the subject of an election to characterize the exchange gain as capital gain or loss subsequently becomes part of a straddle under section 1092(c) (but without regard to subsections (c)(4) or (e)), then the election shall be invalid with respect to gains from such contract and the election may be invalidated with respect to losses.	▪ IRC 988(a)(1)(B) Special rule for forward contracts, etc. ▪ Treas. Reg. 1.988-3(b)(1) Election to characterize exchange gain or loss on certain identified forward contracts, futures contracts and option contracts as capital gain or loss ▪ Treas. Reg. 1.988-3(b)(2) Special Rule for contracts that become part of a straddle after an election is made

Detailed Explanation of the Concept (cont'd)

Character of Exchange Gain or Loss on Currency Transactions

Financial Instruments: In general, the character of the exchange gain or loss will be ordinary. There are special rules and exceptions to the general rule for certain identified forward contracts, futures contracts and option contracts and also for any regulated futures contract or non-equity option which would be marked to market.

Analysis	Resources
▪ There is an exception for any regulated futures contract or non-equity option which would be marked to market, in accordance with IRC 1256. The exchange gain or loss, in this case, would be capital, unless the taxpayer makes an election to treat mark to market as ordinary gain or loss.	▪ IRC 988(c)(1)(D)(i) and Treas. Reg. 1.988-1(a)(7)(i) – exception for certain instruments marked to market. ▪ IRC 988(c)(1)(D)(ii) and Treas. Reg. 1.988-1(a)(7)(ii)-(iv) – Election out ▪ BNA 921-2nd – TMFEDPORT No. 921 §III Foreign Currency Transactions C.9.f. Special Rules for Regulated Futures Contracts and Nonequity Options.

Detailed Explanation of the Concept (cont'd)

Character of Exchange Gain or Loss on Currency Transactions

Disposition of Nonfunctional Currency: In general, the character of the exchange gain or loss on a disposition of nonfunctional currency will be ordinary. There is an exception to the general rule for individual taxpayers in personal transactions.

Analysis	Resources
▪ The character of the exchange gain or loss from the disposition of nonfunctional currency is generally ordinary.	▪ IRC 988(a)(1)(A) and 988(c)(1)(C) ▪ Treas. Reg. 1.988-1(a)(i) and 1.988-3(a) ▪ BNA 921-2nd – TMFEDPORT No. 921 §III Foreign Currency Transactions C.4 Disposition of Nonfunctional Currency.

Detailed Explanation of the Concept (cont'd)

Character of Exchange Gain or Loss on Currency Transactions

Disposition of Nonfunctional Currency: In general, the character of the exchange gain or loss on a disposition of nonfunctional currency will be ordinary. There is an exception to the general rule for individual taxpayers in personal transactions.

Analysis	Resources
▪ There is an exception for individual taxpayers. IRC 988 does not apply if an individual disposes of nonfunctional currency in a personal transaction.	▪ IRC 988(e) Application to individuals and Treas. Reg. 1.988-1(a)(9) Exceptions for certain transactions entered into by an individual ▪ BNA 921-2nd – TMFEDPORT No. 921 §III Foreign Currency Transactions C.11 Special Rules for Foreign Currency Transactions of an Individual ▪ Bittker and Lokken Part 9 Chapter 74.12 Nonfunctional Currency Held for Personal Use. ▪ See IPS Concept Unit Overview of IRC Section 988 Nonfunctional Currency Transactions DCN FCU/CU/C_18.2.1_03

Training and Additional Resources

Chapter 18.2.1 Computation of Exchange Gain or Loss - General

Type of Resource	Description(s) and/or Instructions for Accessing	References
Saba Meeting sessions	▪ IBC ONLY – Foreign Currency & Int'l Matrix (Saba – Public Recordings – Event ID JVQ439517) ▪ IBC Common Errors in translating Foreign Currency 44 (Saba – Public Recordings – Event ID PHG711242) ▪ The Building Blocks of Financial Products (Saba – Public Recordings – Search on "Building Blocks of Financial Products)	▪ 2011 Saba – Foreign Currency & Intl Matrix ▪ 2012 Saba –Common Errors in translating Foreign Currency 44 ▪ 2013 Saba – The Building Blocks of Financial Products
Other Training Materials (Saba Meeting sessions)	IE Phase III Hybrid sessions: ▪ IRC 985 and 989 :Foreign Currency Terms and Definitions ▪ Section 986 Translation Rules ▪ Sec 987 – Branch rules and CTB rules ▪ Foreign Currency Section 988 Transactions ▪ Foreign Currency Hedging ▪ Financial Products Basics – Four Major Categories	▪ 2015 Saba – FC 1 Sec 985 (HQL168303) ▪ 2015 Saba – FC 2 986 Transition Rules (FRS408475) ▪ 2015 Saba – FC 3 987 Branch Rules & CTB (LVP748808) ▪ 2015 Saba – FC 4 Sec 988 Transactions (FTS047865) ▪ 2015 Saba – FC 5 Foreign Currency Hedging (HTS256974) ▪ 2015 Saba – Financial Products Basics (JNN441732)

Training and Additional Resources

Chapter 18.2.1 Computation of Exchange Gain or Loss - General

Type of Resource	Description(s) and/or Instructions for Accessing	References
Other Training Materials	▪ E Phase I, Module E – Lesson 1 Foreign Currency http://lmsb.irs.gov/hq/mf/training/international/phase1/phase_1.asp, Select Module E ▪ IE Phase III, Module D –Interaction of International and Financial Products Issues http://lmsb.irs.gov/hq/mf/training/international/phase3/phase_3.asp, Select Module 5.D., second lesson	
Other Training Materials	▪ FP Phase I, Lesson 9 Foreign Currency ▪ FP Phase I, Download Financial Products Phase One Participant Guide, then proceed to Lesson 9, page 9-1. ▪ FP Phase III, Lesson 4 Foreign Currency ▪ FP Phase III, Download Financial Products Phase Three Participant Guide, then proceed to Lesson 4, page 110.	

Training and Additional Resources (cont'd)

Chapter 18.2.1 Computation of Exchange Gain or Loss - General

Type of Resource	Description(s) and/or Instructions for Accessing	References
Bittker & Lokken – Federal Taxation of Income, Estates and Gifts	▪ Bittker and Lokken Chapter 74. Foreign Currency (Westlaw subscription)	▪ FIXIEG Ch 74
BNA Tax Management Portfolio	▪ BNA Portfolio 921-2nd Tax Aspects of Foreign Currency (Westlaw subscription)	▪ BNA 921-2nd – TMFEDPORT No 921 s
Keyes: Federal Taxation of Financial Instruments and Transactions	▪ Keyes Chapter 15. Foreign Currency Denominated Instruments (Westlaw subscription)	
Accounting Standards Codification (Financial Accounting Standards)	▪ ASC830 (FAS52) Foreign Currency Matters ▪ Available at https://asc.fasb.org. Will need to register for a free "basic view" service. ▪ Westlaw subscription: IRS LB&I Tab. Under Financial Accounting, choose RIA FASB Codification Complete Analysis, Table of Contents. ASC 830 is under the Broad Transactions in the Codification section.	

Glossary of Terms and Acronyms

Term/Acronym	Definition
ASC	Accounting Standard Codification
FAS	Financial Accounting Standards
QBU	Qualified Business Unit
Forward Contract	A customized contract between two parties to buy or sell an asset at a specified price on a future date.
Functional Currency	The currency of the primary economic environment in which the entity operates.
Futures Contract	A contract between two parties where both parties agree to buy and sell a particular asset of specific quantity and at a predetermined price, at a specified date in the future.
Non-Equity Option	A term for option contracts whose underlying securities are instruments other than equities.
Nonfunctional Currency	A currency utilized by an entity for a transaction that is not the functional currency of the entity.
Option Contract	A contract that allows the holder to buy or sell an underlying security at a specified price.
Regulated Futures Contract	A specific futures contract, as defined in IRC 1245, that is held by a taxpayer at the end of a tax period but treated as if it was sold for its fair market value, and gains or losses are treated as either short-term or long-term capital gains.
Section 988 Transaction	Transactions as defined in IRC 988(c)(1)(B)

Back to Table Of Contents

Index of Related Issues

Issue	Associated UIL(s)	References
How to Assess Penalties for Failure to file Form 8886 Disclosing Section 988 Losses	▪ 9470.02	▪ FCU/9470.02_02
Overview of Foreign Currency Hedging Transactions	▪ 9470.02	▪ FCU/CU/C_18.2.3_14
Integration of Executory Contract and the Currency Hedge	▪ 9470.02	▪ FCU/9470.02_05
Legging into Integrated Treatment	▪ 9470.02	▪ FCU/9470.02_07
Disposition of a Portion of an Integrated Hedge	▪ 9470.02	▪ FCU/9470.02_03
Disposition of Nonfunctional Currency	▪ 9470.02	▪ FCU/9470.02_01_04
Functional Currency of a Qualified Business Unit (QBU)	▪ 9470.03	▪ FCU/PUO/C_18.3.3_08
Sourcing of Exchange Gains or Losses	▪ 9470.02	▪ FCU/CU/C-18.2.1_17
Overview of the Impact of Foreign Currency Exchange Rate Fluctuations	▪ 9470.02	▪ FCU/CU/C-18.2.1_16

Back to Table Of Contents

Index of Related Issues (cont'd)

Issue	Associated UIL(s)	References
Computing Foreign Base Company Income	▪ 9412.05	▪ DPL/9412.05_05
Subpart F Overview	▪ 9412	▪ DPL/CBB/V_2_01
Calculation of IRC §956 Amount	▪ 9414.01	▪ Under Development

Internal Revenue Service
DEPARTMENT OF THE TREASURY

LB&I International Practice Service Concept Unit

IPS Level	Number	Title	UIL Code	Number
Shelf	N/A	Crossover IPN	–	–
Volume	18	Foreign Currency	**Level 1 UIL**	9470
Part	18.2	Transactions in a foreign currency - §988	**Level 2 UIL**	9470.02
Chapter	18.2.1	Computation of exchange gain or loss - general	**Level 3 UIL**	9470.02-01
Sub-Chapter	N/A	N/A	–	–

Unit Name	Overview of IRC Section 988 Nonfunctional Currency Transactions

Document Control Number (DCN)	FCU/CU/C_18.2.1_03(2016)
Date of Last Update	06/01/2016

Table of Contents

(View this PowerPoint in "Presentation View" to click on the links below)

General Overview

Overview of IRC Section 988 Nonfunctional Currency Transactions

This Concept Unit covers the following:
1) “Functional currency” (FC) and its application,
2) Definition of Section 988 transactions,
3) Computation of foreign currency gain/loss under IRC 988 on receivables/payables denominated in a nonfunctional currency (including US GAAP ASC 830 (formerly FAS 52) differences), and
4) Computation of foreign exchange gain/loss under IRC 988 on debt instruments denominated in a nonfunctional currency.

Except as provided in the code and regulations, a taxpayer’s functional currency is the US dollar (USD). A taxpayer or a Qualified Business Unit (QBU) - any separate and clearly identified unit of a taxpayer that maintains separate books and records) may, under certain circumstances, have a non-USD functional currency (see IRC 985(b); Treas. Reg. 1.985-1(b) and (c)). Note that US Corporations must have the USD as their functional currency, although their foreign branches may have non-USD functional currencies (a QBU can have a functional currency that is different from its owner). The functional currency is relevant for taxpayers that have transactions in multiple currencies. Transactions are accounted for in the taxpayer's functional currency. Certain nonfunctional currency transactions, called “Section 988 transactions” generally give rise to functional currency gain or loss.

Transactions that require the use of a currency other then US dollar have dramatically increased as more taxpayers do business globally. Generally, when US resident taxpayers invest and do business transactions in non US currency, all federal tax determinations must be made in USD. Section 988 transactions include debt instruments, payables, receivables, forward contracts, futures contracts, options or similar instruments denominated in any nonfunctional currency. Also when a taxpayer owns or has a position in a nonfunctional currency asset or liability that generates a Section 988 transaction, the US taxpayer must calculate foreign currency gain or loss. (See the above paragraph for a description of the term “functional currency.”) Sections 985 to 989 provide rules for making translations and measuring foreign currency gain or losses.

IRC 988 and its regulations generally provide that foreign currency gain or loss with respect to a transaction is (1) recognized at the time of the sale or disposition of nonfunctional currency denominated property, (2) characterized as ordinary gain or loss, and (3) sourced based upon the residence of the holder.

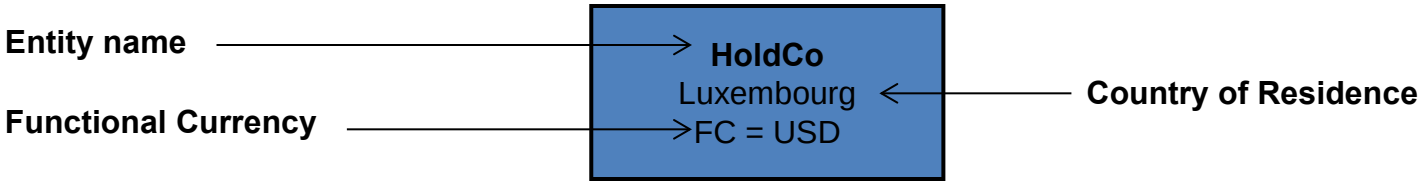
General Overview (cont'd)

Overview of IRC Section 988 Nonfunctional Currency Transactions

IRC Sections 985 to 989 provide rules for translating tax items into a taxpayer's functional currency and measuring foreign currency gain and losses. In general:

- Section 985 - Defines functional currency including hyperinflationary currency
- Section 986 - Addresses the translation into USD of foreign taxes and foreign corporation's earning and profits
- Section 987 - Addresses branch transactions when the QBU has a different functional currency than the taxpayer
- Section 988 - Describes treatment of certain foreign currency transactions
- Section 989 – Defines a qualified business unit (QBU) and appropriate exchange rate

This IPS Unit will focus on the basic functional currency concepts and the treatment of certain nonfunctional currency transactions under IRC 988. For each example listed in the Examples section of this unit, the first line of the diagram description will reflect the entity name and the second line will reflect the functional currency (FC) of the entity:



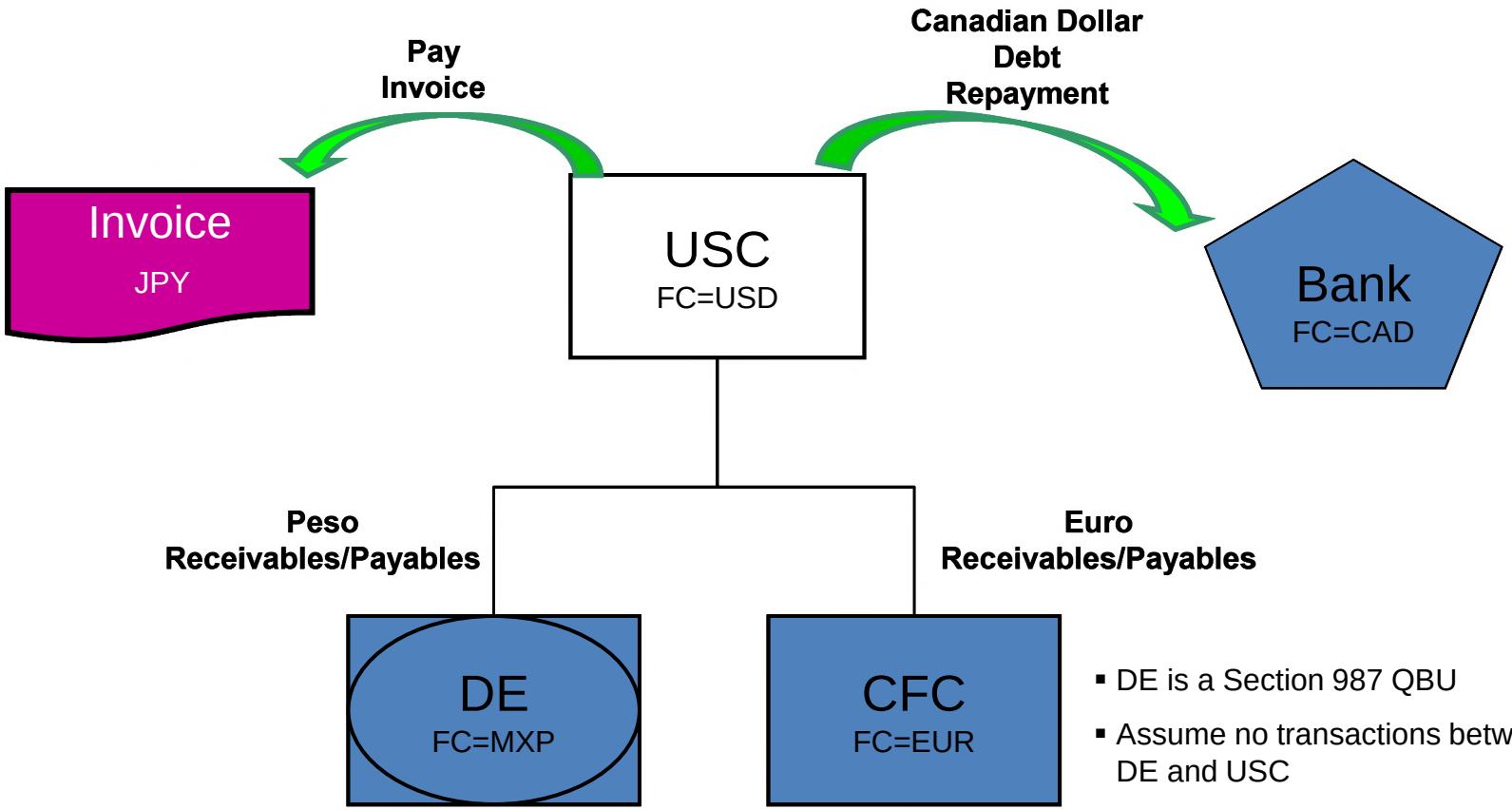
Other IPS units for IRC 989, IRC 987 and other foreign currency issues are in the IPS library.

Note: The Internal Revenue Code refers to foreign currency gains and losses while the Treasury Regulations use the term exchange gain or loss.

Diagram of Concept

Overview of IRC Section 988 Nonfunctional Currency Transactions

Diagram of Concept



- DE is a Section 987 QBU
- Assume no transactions between DE and USC

Facts of Concept

Overview of IRC Section 988 Nonfunctional Currency Transactions

Facts of Concept

It is very common that US companies will be transacting in currencies other then the US dollar. Examiners need to understand:

- the cash flow of these transactions,
- how they are recorded for financial accounting and tax purposes, and
- any foreign currency gain or loss that should be reported, as well as the source (US or foreign) and character (ordinary or capital) of the transaction.

Nonfunctional currency transaction amounts have to be translated into functional currency. An example of this type of transaction is paying an invoice in a nonfunctional currency. For example, in the Diagram of Concept (prior slide), USC's invoice is payable in Japanese Yen.

When the US taxpayer owns foreign currency or has a position in a non-US currency asset or liability, examiners need to be able to measure, translate and establish when foreign currency gains and losses should be determined. For example, in the Diagram of Concept (prior slide), USC has both Euro denominated receivables/payables and a Canadian Dollar debt.

Detailed Explanation of the Concept

Overview of IRC Section 988 Nonfunctional Currency Transactions

What is a Section 988 transaction? Generally, it is a transaction where the amount that the taxpayer is entitled to receive or required to pay is determined in a currency other than the functional currency of the taxpayer or is determined in reference to the value of one or more nonfunctional currencies. These transactions are described in greater detail below.

Analysis	Resources
Subject to certain statutory exceptions, transactions include: ▪ (i) the acquisition of a debt instrument or becoming the obligor under a debt instrument; ▪ (ii) accruing (or otherwise taking into account) any items of expense or gross income or receipts which is to be paid or received after the date on which so accrued or taken into account (i.e., payable and receivables, provided that for tax purposes, the accrual and payment dated are distinct); and ▪ (iii) entering into or acquiring any forward contract, futures contract, option, or similar financial instrument.	▪ IRC 988(c)(1)(B) and Treas. Reg. 1.988-1(a)(2)
The disposition of any nonfunctional currency is also treated as a Section 988 transaction and any gain or loss arising from such transaction is treated as a foreign currency gain or loss.	▪ IRC 988(c)(1)(C) and Treas. Reg. 1.988-2(a)(1)(i)
Section 988 transactions includes certain financial derivatives. Financial derivatives such as forwards, futures, options contracts, etc. are used by taxpayers to reduce exposure to underlying currency and asset transfer risks. The Internal Revenue Code establishes different tax rules governing how and when foreign currency gains and losses are taxed for different financial instruments. **CONSULTATION:** When a transaction includes complex financial derivatives, the Examiner should consult with a Financial Products Examiner.	▪ IRC 988(c)(1)(D) – (E) and 988(d) ▪ See IPS Concept Unit Overview of Foreign Currency Hedging Transactions DCN FCU/CU/C_18.2.3_14

Detailed Explanation of the Concept (cont'd)

Overview of IRC Section 988 Nonfunctional Currency Transactions

How are Section 988 transactions treated for tax purposes? While the transactions are generally treated as ordinary income, certain exceptions, rules and elections exist that treat these transactions as capital in nature. Likewise, these transactions are generally sourced based on the residence of the taxpayer; however there are exceptions to this rule.

Analysis	Resources
Foreign currency gain or loss attributable to a section 988 transaction is computed separately and generally treated as ordinary.	▪ IRC 988(a)(1)(A) and Treas. Reg. 1.988-3(a)
However, a taxpayer or QBU may elect to treat gain or loss on certain forwards, futures, and options as capital gain or loss.	▪ IRC 988(a)(1)(B) and Treas. Reg. 1.988-3(b) ▪ See IPS Concept Unit on Character of Exchange Gain or Loss on Currency Transactions, DCN FCU/CU/C-18.2.1_04 for further discussion
Generally, the source of foreign currency gain or loss is determined by reference to the residence of the taxpayer or QBU.	▪ IRC 988(a)(3) and Treas. Reg. 1.988-4 ▪ See IPS Concept Unit on Sourcing of Exchange Gains or Losses, DCN FCU/CU/C-18.2.1_17 for further discussion

Detailed Explanation of the Concept (cont'd)

Overview of IRC Section 988 Nonfunctional Currency Transactions

What about other transactions denominated in nonfunctional currency? IRC Section 988 clearly defines transactions covered under this subchapter. Therefore, while other transactions may have foreign currency components as discussed below, the character and sourcing of these transactions are not governed by IRC Section 988 and are therefore both sourced and characterized by separate Code sections.

Analysis	Resources
Transactions not defined in IRC 988 are not treated as Section 988 transactions. Fluctuations in exchange rates may nonetheless generate foreign currency gains or losses realized by a taxpayer on other transactions.	▪ See IPS Concept Unit on Overview of the Impact of Foreign Currency Exchange Rate Fluctuations" DCN FCU/CU/C-18.2.1_16
For example, purchasing stock in a nonfunctional currency is not a Section 988 transaction because stock is not a Section 988 asset. A taxpayer generally determines its basis in the stock and amount realized upon disposition of the stock using a spot rate. However, the initial acquisition of nonfunctional currency and subsequent disposition of nonfunctional currency to acquire the stock would be a Section 988 transaction if the acquisition and disposition of the currency occurred on separate dates.	▪ IRC 1221 ▪ IRC 988(c)(1)(C)
Example: Assume Dorfman Corp, a taxpayer with USD as its functional currency, purchased a share of stock for LC100 when LC100=USD100. Assume Dorfman Corp holds the stock as capital asset. Further assume that Dorfman Corp sold the stock for LC100 when LC100=USD150. Dorfman Corp had a USD50 gain attributable to the stock. However, because holding stock is not a defined Section 988 transaction, the USD50 gain would not be foreign currency gain. The gain on the stock is a capital gain.	

Examples of the Concept

Overview of IRC Section 988 Nonfunctional Currency Transactions

Examples

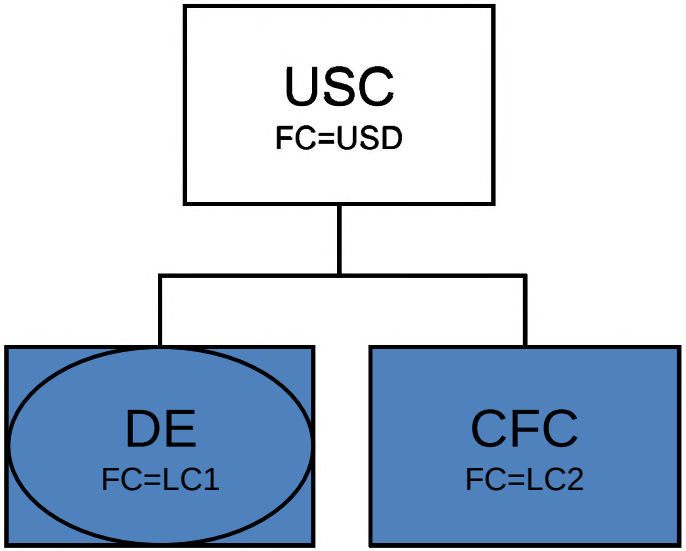


Illustration #1 - Understand the term functional currency (FC), its application, and IRC 988 application

Facts:

- USC owns two foreign entities; DE and CFC.
- DE manufactures in Foreign Country 1 and maintains its own separate books and records using currency LC1. DE is a QBU.
- CFC sells products in Foreign Country 2 and also has its own separate books and records using currency LC2. CFC is a QBU.

Results:

- USC FC is the USD. See Treas. Reg. 1.985-1(b).
- DE is a QBU with FC being LC1. See Treas. Regs. 1.985-1(c) and 1.989(a)-1(b)(1); IRC 987.
- CFC is a QBU with FC being LC2. See Treas. Reg. 1.985-1(c) and 1.989(a)-1(b)(2) (providing that a corporation is a per se QBU).
- DE and CFC's profit and loss at the end of the year is translated to dollars using the average exchange rate for the year after making US GAAP adjustments. The DE profit or loss (P/L) flows into USC's Form 1120; however CFC's P/L is deferred and reported as information on Form 5471. The CFC's gains on an Section 988 transaction (debt/receivable/payable/options etc.) is foreign personal holding company income (FPHCI), unless an exception (e.g., business needs) applies. See IRC 954(c)(1)(D) and Treas. Reg. 1.954-2(g)(2)(ii).

NOTE: For definition of QBU, see *Overview of Qualified Business Units (QBU),* DCN FCU/CU/C_18.3.1_02.

Back to Table Of Contents

Examples of the Concept (cont'd)

Overview of IRC Section 988 Nonfunctional Currency Transactions

Examples

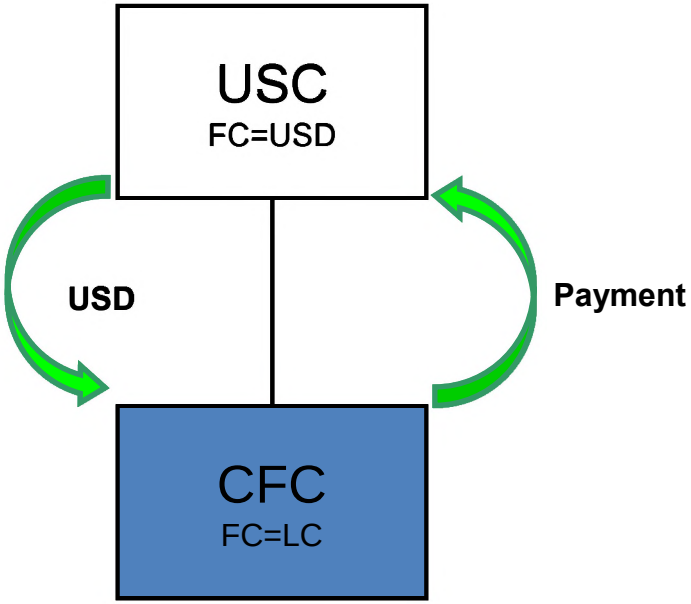


Illustration #2 - Loan denominated in a nonfunctional currency including US GAAP (ASC 830-20-35, formerly FAS 52) differences

Facts:

- USC's functional currency is the US Dollar (USD) and CFC's functional currency is LC. USC advances USD100 to CFC, on 12/01/20X1 when the exchange is USD1:LC1. Rate changes to USD1:LC1.25 on 12/31/20X1 and to USD1:LC1.5 on 03/31/20X2 when the loan is paid.
- CFC's loan payable is a Section 988 transaction.

Results – Accounting:

- Re-measurement is required by US GAAP (ASC 830) for financial accounting purposes. The CFC will record an unrealized financial loss in the P&L at 12/31/X1 and then recognize a realized financial loss on 03/31/X2 as noted below:

Unrealized Loss @ 12/31/20X1 = $100 x (1.25-1.00) = $25 loss

Realized Loss @ 03/31/20X2 = $100 x (1.50 – 1.00) = $50 total loss

Less unrealized loss previously recognized: ($25)

Additional Loss booked on 03/31/20X2: $25 loss in 20X2

! CAUTION: Special Treatment of Intercompany transactions (within consolidated, combined groups or equity accounting) treated as part of the net investment , see ASC 830-20-35-5:

- If an intercompany foreign currency transaction is of a "long-term investment" nature, foreign currency transaction G/L are reported in other comprehensive income (OCI) rather than through the P&L.

Back to Table Of Contents

Examples of the Concept (cont'd)

Overview of IRC Section 988 Nonfunctional Currency Transactions

Examples

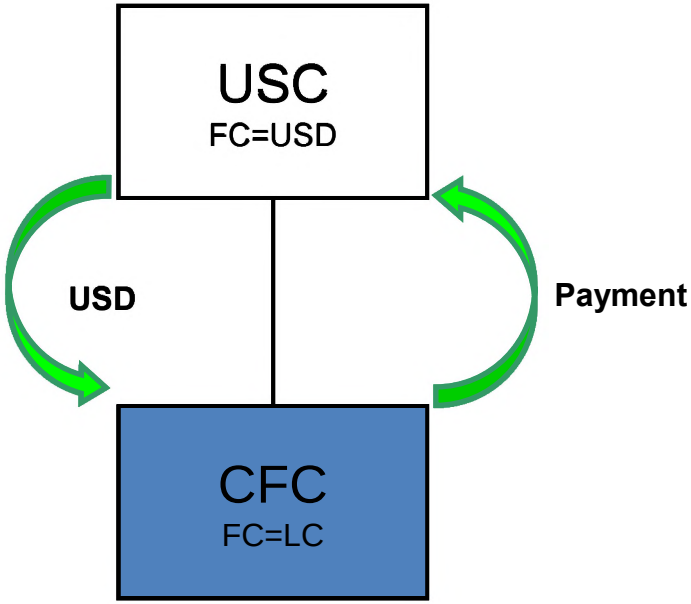


Illustration #2 (cont'd)

Results – Tax:

- Realized gains/losses (G/L) are recognized in the year that the payment is made. See Treas. Reg. 1.988-2(b)(6). CFC recognizes a loss in earnings and profits (E&P) in 03/31/X2 as noted below:

Realized Loss @ 03/31/20X2 = $100 x (1.50 – 1.00) = $50 total loss

Assuming debt treatment for US GAAP

	Financial Accounting P&L	Tax E&P	Sch M-3 E&P Adj
12/31/20X1	(25)	0	25
12/31/20X2	(25)	(50)	(25)

Assuming long-term investment for US GAAP

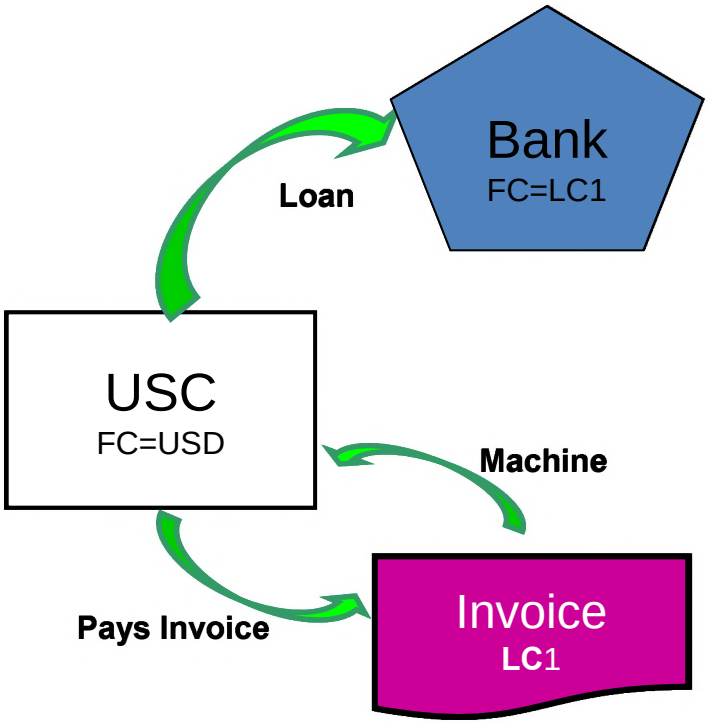
	Financial Accounting P&L	Tax E&P	Sch M-3 E&P Adj
12/31/20X1	-	0	-
12/31/20X2	-	(50)	(50)

- Unrealized gains / losses (G/L) recorded for financial accounting may be incorrectly reported for tax purposes or not reported when paid for tax purposes in the following year.
- Schedule H of Form 5471 for the CFC should be analyzed to determine the taxpayer's treatment of the transaction and to ascertain whether additional E&P adjustments are required.

Back to Table Of Contents

Examples of the Concept (cont'd)

Overview of IRC Section 988 Nonfunctional Currency Transactions



Examples

Illustration #3 – IRC 988 computation of realized foreign currency gain or loss on a nonfunctional currency payable

Facts:

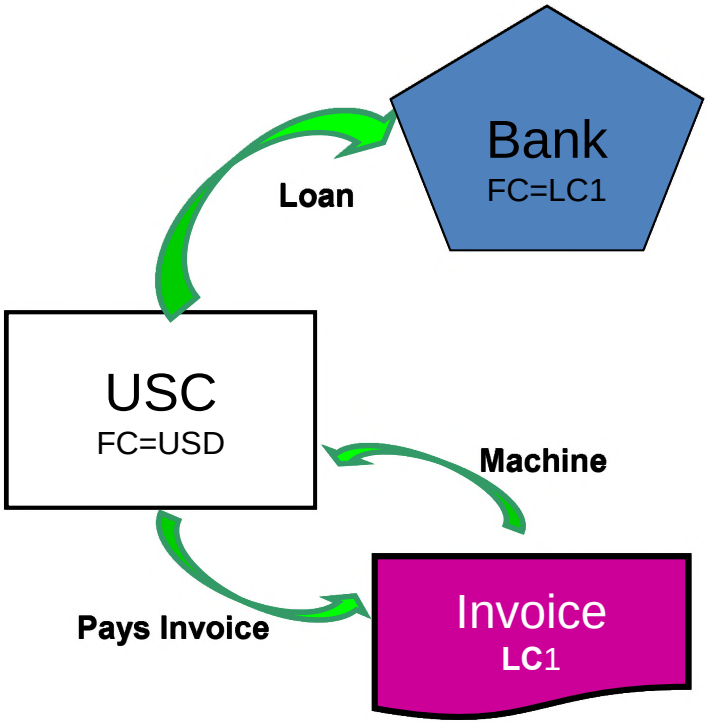
- USC, an accrual basis taxpayer with USD FC, borrowed from a bank in 20X2.
- The loan from bank is a 5 year note with a face amount of LC1 100 with interest accruing quarterly.
- USC separately orders a machine for LC1 100. The machine invoice term is 60 day upon delivery. The LC1 is worth $110 US dollars when the machine is received (and the expense accrues) and $105 US dollars when the invoice is paid.

Results:

- Purchase of machine is not an Section 988 transaction. USC records an asset for $110 and an accounts payable of $110 when machine is received. See generally IRC 988.
- Disposition or payment of accounts payable would be an Section 988 transaction and give rise to foreign currency gain or loss – an ordinary gain of $5 US dollars under Treas. Reg. 1.988-3(a) and US source under residence rule of sourcing.
- The five year note denominated in terms of a nonfunctional currency is an Section 988 transaction and gain/loss recognized when paid (see Illustration #4).

Examples of the Concept (cont'd)

Overview of IRC Section 988 Nonfunctional Currency Transactions



Examples

Illustration #4 – IRC 988 nonfunctional currency debt instrument and computation of realized and unrealized foreign currency gains or losses

Facts:

- USC, an accrual basis taxpayer with USD as its functional currency, borrowed from bank in 20X2 to purchase a machine.
- Loan from bank is a five year note with a face amount of LC1 100 with quarterly payment of interest only.
  - Note when acquired: USD 101 = LC1 100
  - Note at the end of 20X2 BS measurement date: USD 94 = LC1 100
  - Note paid in full when USD 90 = LC1 100

Results:

- Five year note denominated in terms of a non-FC is a Section 988 transaction and foreign currency gain/loss is recognized for tax purposes when paid.
- Unrealized G/L not recognized while note is outstanding.

For financial purposes, an unrealized foreign currency gain of USD7 will be reported at the end of 20X2.

- FC tax gain of USD11 is recognized when 5 year note paid.
- Accrued interest expense is also an Section 988 item in accordance with Treas. Reg. 1.988-1(a)(1)(ii) and Treas. Reg. 1.988-1(a)(2)(ii), and gain or loss is recognized when accrued payments are made, as determined under Treas. Reg. 1.988-2(b)(3) & (4).

Back to Table Of Contents

Training and Additional Resources

Chapter 18.2.1 Computation of Exchange Gain or Loss - General		
Type of Resource	**Description(s) and/or Instructions for Accessing**	**References**
Saba Meeting sessions	▪ IBC ONLY – Foreign Currency & Int'l Matrix (Saba – Public Recordings – Event ID JVQ439517) ▪ IBC Common Errors in translating Foreign Currency 44 (Saba – Public Recordings – Event ID PHG711242) ▪ The Building Blocks of Financial Products (Saba – Public Recordings – Search on "Building Blocks of Financial Products)	▪ 2011 Saba – Foreign Currency & Intl Matrix ▪ 2012 Saba –Common Errors in translating Foreign Currency 44 ▪ 2013 Saba – The Building Blocks of Financial Products
Other Training Materials (Saba Meeting sessions)	IE Phase III Hybrid sessions: ▪ IRC 985 and 989 :Foreign Currency Terms and Definitions ▪ Section 986 Translation Rules ▪ Sec 987 – Branch rules and CTB rules ▪ Foreign Currency Section 988 Transactions ▪ Foreign Currency Hedging ▪ Financial Products Basics – Four Major Categories	▪ 2015 Saba – FC 1 Sec 985 (HQL168303) ▪ 2015 Saba – FC 2 986 Transition Rules (FRS408475) ▪ 2015 Saba – FC 3 987 Branch Rules & CTB (LVP748808) ▪ 2015 Saba – FC 4 Sec 988 Transactions (FTS047865) ▪ 2015 Saba – FC 5 Foreign Currency Hedging (HTS256974) ▪ 2015 Saba – Financial Products Basics (JNN441732)

Back to Table Of Contents

Training and Additional Resources (cont'd)

Chapter 18.2.1 Computation of Exchange Gain or Loss - General		
Type of Resource	**Description(s) and/or Instructions for Accessing**	**References**
Other Training Materials	▪ IE Phase I, Module E – Lesson 1 Foreign Currency http://lmsb.irs.gov/hq/mf/training/international/phase1/phase_1.asp, Select Module E ▪ IE Phase III, Module D –Interaction of International and Financial Products Issues http://lmsb.irs.gov/hq/mf/training/international/phase3/phase_3.asp, Select Module 5.D., second lesson	
Other Training Materials	▪ FP Phase I, Lesson 9 Foreign Currency ▪ FP Phase I, Download Financial Products Phase One Participant Guide, then proceed to Lesson 9, page 9-1. ▪ FP Phase III, Lesson 4 Foreign Currency ▪ FP Phase III, Download Financial Products Phase Three Participant Guide, then proceed to Lesson 4, page 110.	

Training and Additional Resources (cont'd)

Chapter 18.2.1 Computation of Exchange Gain or Loss - General		
Type of Resource	**Description(s) and/or Instructions for Accessing**	**References**
Bittker & Lokken – Federal Taxation of Income, Estates and Gifts	▪ Bittker and Lokken Para 74.2 Functional Currency (Westlaw subscription)	▪ FIXIEG Para 74.2
BNA Tax Management Portfolio	▪ BNA Portfolio 921-2nd Tax Aspects of Foreign Currency (Westlaw subscription)	▪ BNA 921-2nd – TMFEDPORT No 921 s
Keyes: Federal Taxation of Financial Instruments and Transactions	▪ Keyes Chapter 15. Foreign Currency Denominated Instruments	
Mertens Law of Federal Income Taxation	▪ Mertens Chapter 45C. SOURCING OF INCOME AND EXPENSE, III 45C:63 Functional currency — Qualified business unit (Westlaw subscription)	
Accounting Standards Codification (Financial Accounting Standards)	▪ ASC830 (FAS52) Foreign Currency Matters ▪ Available at https://asc.fasb.org. Register for free "basic view" service. ▪ Westlaw subscription: IRS LB&I Tab. Under Financial Accounting, choose RIA FASB Codification Complete Analysis, Table of Contents. ASC 830 is under the Broad Transactions in the Codification section.	

Back to Table Of Contents

Glossary of Terms and Acronyms

Term/Acronym	Definition
ASC	Accounting Standard Codification
BS	Balance Sheet
CFC	Controlled Foreign Corporation
DE	Disregarded Entity
E&P	Earnings and Profits
FAS	Financial Accounting Standards
FC	Functional currency
FPHC	Foreign Personal Holding Company
FX	Foreign currency or foreign exchange
G/L	Gain or Loss (or Gains/Losses)
GL	General Ledger
OCI	Other Comprehensive Income
P&L	Profit and Loss Statement (Income Statement)
P/L	Profit or Loss
QBU	Qualified Business Unit
US GAAP	US Generally Accepted Accounting Principles
USD	US Dollar

Back to Table Of Contents

Glossary of Terms and Acronyms (cont'd)

Term/Acronym	Definition
Forward Contract	A customized contract between two parties to buy or sell an asset at a specified price on a future date.
Functional Currency	The currency of the primary economic environment in which the entity operates.
Futures Contract	A contract between two parties where both parties agree to buy and sell a particular asset of specific quantity and at a predetermined price, at a specified date in the future.
Nonfunctional Currency	A currency utilized by an entity for a transaction that is not the functional currency of the entity.
Option Contract	A contract that allows the holder to buy or sell an underlying security at a specified price.
Section 988 Transaction	Transactions as defined in IRC 988(c)(1)(B)

Index of Related Issues

Issue	Associated UIL(s)	References
Overview of Foreign Currency Hedging Transactions	▪ 9470.02	▪ FCU/CU/C_18.2.3_14
Overview of the Impact of Foreign Currency Exchange Rate Fluctuations	▪ 9470.02	▪ FCU/CU/C-18.2.1_16
Disposition of Nonfunctional Currency	▪ 9470.02	▪ FCU/9470.02_01_04
IRC 988 currency gain or loss determination	▪ 9470.02	▪ FCU/PUO/C_18.2.1_09
Character of Exchange Gain or Loss on Currency Transactions	▪ 9470.02	▪ FCU/CU/C-18.2.1_04
Sourcing of Exchange Gains or Losses	▪ 9470.02	▪ FCU/CU/C-18.2.1_17
Exchange Gain/Loss on Debt Instruments	▪ 9470.02	▪ FCU/CU/C_18.2.1_09
Integration of Executory Contract and the Currency Hedge	▪ 9470.02	▪ FCU/9470.02_05
Legging into Integrated Treatment	▪ 9470.02	▪ FCU/9470.02_07

Back to Table Of Contents

Index of Related Issues (cont'd)

Issue	Associated UIL(s)	References
Disposition of a Portion of an Integrated Hedge	▪ 9470.02	▪ FCU/9470.02_03
How to Assess Penalties for Failure to file Form 8886 Disclosing Section 988 Losses	▪ 9470.02	▪ FCU/9470.02_02
Functional Currency of a Qualified Business Unit (QBU)	▪ 9470.03	▪ FCU/PUO/C_18.3.3_08
Overview of Qualified Business Units (QBUs)	▪ 9470.03	▪ FCU/CU/C_18.3.1_02
Computing Foreign Base Company Income	▪ 9412.05	▪ DPL/9412.05_05
Subpart F Overview	▪ 9412	▪ DPL/CU/V_2_01
Calculation of IRC §956 Amount	▪ 9414.01	▪ Under Development

Internal Revenue Bulletin: 2003-51

December 22, 2003

Notice 2003-81

Tax Avoidance Using Offsetting Foreign Currency Option Contracts

Table of Contents

The Internal Revenue Service and the Treasury Department are aware of a type of transaction, described below, in which a taxpayer claims a loss upon the assignment of a section 1256 contract to a charity but fails to report the recognition of gain when the taxpayer's obligation under an offsetting non-section 1256 contract terminates. This notice alerts taxpayers and their representatives that these transactions are tax avoidance transactions and identifies these transactions, and those that are substantially similar to these transactions, as listed transactions for purposes of § 1.6011-4(b)(2) of the Income Tax Regulations and §§ 301.6111-2(b)(2) and 301.6112-1(b)(2) of the Procedure and Administration Regulations. This notice also alerts parties involved with these transactions of certain responsibilities that may arise from their involvement with these transactions.

FACTS

A taxpayer pays premiums to purchase a call option and a put option (the purchased options) on a foreign currency. The currency is one in which positions are traded through regulated futures contracts, and the purchased options, therefore, are foreign currency contracts within the meaning of section 1256(g)(2)(A) of the Internal Revenue Code and section 1256 contracts within the meaning of section 1256(b). The purchased options are reasonably expected to move inversely in value to one another over a relevant range, thus ensuring that, as the value of the underlying foreign currency changes, the taxpayer will hold a loss position in one of the two section 1256 contracts. The taxpayer also receives premiums for writing a call option and a put option (the written options) on a different foreign currency in which positions are not traded through regulated futures contracts. Thus, the written options are not foreign currency contracts within the meaning of section 1256(g)(2)(A), nor are they section 1256 contracts within the meaning of section 1256(b). The written options are reasonably expected to move inversely in value to one another over a relevant range, thus ensuring that, as the value of the underlying foreign currency changes, the taxpayer will hold a gain position in one of the two non-section 1256 contracts.

The values of the two currencies underlying the purchased and written options (i) historically have demonstrated a very high positive correlation with one another, or (ii) officially have been linked to one another, such as through the European Exchange Rate Mechanism (ERM II). Thus, as the currencies change in value, the taxpayer reasonably expects to have the following potential gains and losses in substantially offsetting positions: (1) a loss in a purchased option and a gain in a written option; and (2) a gain in a purchased option and a loss in a written option. At any time, the taxpayer's loss in the purchased option position that has declined in value may be more or less than the taxpayer's gain in the offsetting written option position that has appreciated in value. Similarly, the taxpayer's gain in the remaining purchased option position may be more or less than the taxpayer's loss in the remaining written option position. A material pre-tax profit or rate of return, or both, on the transaction is possible but unlikely.

The taxpayer assigns to a charity the purchased option that has a loss. The charity also assumes the taxpayer's obligation under the offsetting written option that has a gain. As with all written options, the amount of gain on the option is limited to the premium received for the option. In the same tax year, the taxpayer may dispose of the remaining purchased option and offsetting written option.

Because the purchased option assigned to the charity is a section 1256 contract, the taxpayer relies on section 1256(c) and *Greene v. United States*, 79 F.3d 1348 (2d Cir. 1996), to mark to market the purchased option when the option is assigned to the charity and to recognize a loss at that time. In contrast, because the assumed written option is not a section 1256 contract, the taxpayer claims not to recognize gain attributable to the option premium. Specifically, the taxpayer claims that the charity's assumption of the option obligation does not cause the taxpayer to recognize gain and that the taxpayer also does not recognize gain either at the time the option expires or terminates or at any other time.

ANALYSIS

Rev. Rul. 58-234, 1958-1 C.B. 279, *clarified by* Rev. Rul. 68-151, 1968-1 C.B. 363, holds that an option writer does not recognize income or gain with respect to a premium received for writing an option until the option is terminated, without exercise, or otherwise. *Accord* Rev. Rul. 78-182, 1978-1 C.B. 265; *Koch v. Commissioner*, 67 T.C. 71 (1976), *acq.* 1980-2 C.B. 1. Rev. Rul. 58-234 explains that this is the treatment for the option writer because the option writer assumes a burdensome and continuing obligation, and the transaction therefore stays open without any ascertainable income or gain until the writer's obligation is finally terminated. When the option writer's obligation terminates, the transaction closes, and the option writer must recognize any income or gain attributable to the prior receipt of the option premium.

In some cases, the option writer's obligation under the option contract may terminate on the charity's assumption of the written option obligation. In other cases, the writer will have a continuing obligation because the writer may be called upon to perform if the charity fails to perform or to reimburse the charity for any losses or expenses it may incur if called upon to perform. If an assumption terminates the option writer's obligation under the option contract, the option writer must recognize gain when the option obligation is assumed. If the assumption does not terminate the option writer's obligation under the option contract, the option writer must recognize the premium when the option writer's obligation under the option contract terminates (other than through an exercise of the option against, and performance by, the option writer).

These general principles remain applicable even if the assumption of the option writer's obligation is part of what the taxpayer claims is a donative transaction. *Cf. Diedrich v. Commissioner*, 457 U.S. 191 (1982) (noting that if a donee pays a gift tax obligation arising from a donative transfer, the donative nature of the transaction does not preclude income recognition by the donor on the obligation assumed). Here, the taxpayer has made a transfer to the charity of the purchased option, and the charity has assumed the burden of the written option. No aspect of the taxpayer's transfer or the charity's assumption (or their combination) relieves the taxpayer from its duty under the Code to account for the gain attributable to the premium originally received by the taxpayer for assuming the burden of writing the option. *See Lucas v. Earl*, 281 U.S. 111 (1930) (holding that a taxpayer may not avoid inclusion of future earned income by making a gratuitous transfer of the right to receive the income).

Finally, if the taxpayer has any unrecognized gain on the written option at the end of the year in which the assumption occurs (*e.g.*, the assumption did not terminate the option writer's obligation under the option contract), the mark-to-market loss on the offsetting contributed section 1256 contract will be deferred under section 1092.

Transactions that are the same as, or substantially similar to, the transactions described in this notice are identified as "listed transactions" for purposes of §§ 1.6011-4(b)(2), 301.6111-2(b)(2) and 301.6112-1(b)(2) effective December 4, 2003, the date this notice was released to the public. Variations on these transactions may include positions in other section 1256 and non-section 1256 contracts. Independent of their classification as "listed transactions" for purposes of §§ 1.6011-4(b)(2), 301.6111-2(b)(2), and 301.6112-1(b)(2), transactions that are the same as, or substantially similar to, the transaction described in this notice may already be subject to the disclosure requirements of section 6011 (§ 1.6011-4), the tax shelter registration requirements of section 6111 (§§ 301.6111-1T, 301.6111-2), or the list maintenance requirements of section 6112 (§ 301.6112-1). Persons who are required to register these tax shelters under section 6111 but have failed to do so may be subject to the penalty under section 6707(a). Persons who are required to maintain lists of investors under section 6112 but have failed to do so (or who fail to provide those lists when requested by the Service) may be subject to the penalty under section 6708(a). In addition, the Service may impose penalties on parties involved in these transactions or substantially similar transactions, including the accuracy-related penalty under § 6662.

The Service and the Treasury recognize that some taxpayers may have filed tax returns taking the position that they were entitled to the purported tax benefits of the type of transaction described in this notice. These taxpayers should consult with a tax advisor to ensure that their transactions are disclosed properly and to take appropriate corrective action.

The principal author of this notice is Clay Littlefield of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this notice, contact Mr. Littlefield at (202) 622-3920 (not a toll-free call).

Part III – Administrative, Procedural, and Miscellaneous

Modification of Notice 2003-81

Notice 2007-71

This Notice modifies and supplements Notice 2003-81, 2003-2 C.B. 1223, by correcting a statement in the “Facts” portion of Notice 2003-81.

BACKGROUND

On December 4, 2003, the Internal Revenue Service (“Service”) and the Treasury Department (“Treasury”) published Notice 2003-81, which described a tax avoidance transaction involving offsetting foreign currency options and identified such transaction and those substantially similar to it as listed transactions for purposes of § 1.6011-4(b)(2) of the Income Tax Regulations and §§ 301.6111-2(b)(2) and 301.6112-1(b)(2) of the Procedure and Administration Regulations.

In the transaction described in Notice 2003-81, a taxpayer pays premiums to purchase a call option and a put option (the purchased options) on a foreign currency in which positions are traded through regulated futures contracts. The purchased options are reasonably expected to move inversely in value to one another over a relevant range, thus ensuring that, as the value of the underlying foreign currency changes, the taxpayer will hold a loss position in one of the two purchased options. The taxpayer also receives premiums for writing a call option and a put option (the written options) on a different foreign currency in which positions are not traded through regulated futures contracts. The taxpayer takes the position that the written options are neither foreign currency contracts within the meaning of § 1256(g)(2)(A) nor §1256 contracts within the meaning of §1256(b). The written options are reasonably expected to move inversely in value to one another over a relevant range, thus ensuring that, as the value of the underlying foreign currency changes, the taxpayer will hold a gain position in one of the two written options.

The values of the two currencies underlying the purchased and written options (i) historically have demonstrated a very high positive correlation with one another, or (ii) officially have been linked to one another, such as through the European Exchange Rate Mechanism (ERM II). Thus, as the currencies change in value, the taxpayer reasonably expects to have the following potential gains and losses in substantially offsetting positions: (1) a loss in a purchased option and a gain in a written option; and (2) a gain in a purchased option and a loss in a written option. At any time, the taxpayer's loss in the purchased option position that has declined in value may be more or less than the taxpayer's gain in the offsetting written option position that has appreciated in value. Similarly, the taxpayer's gain in the remaining purchased option position may be more or less than the taxpayer's loss in the remaining written option position. A material pre-tax profit or rate of return, or both, on the transaction is possible but unlikely.

The taxpayer assigns to a charity the purchased option that has a loss. The charity also assumes the taxpayer's obligation under the offsetting written option that

has a gain. The premium received on that written option is not assigned but is retained by the taxpayer. As with all written options, the amount of gain on the option is limited to the premium received for the option. In the same tax year, the taxpayer may dispose of the remaining purchased option and offsetting written option.

Because the taxpayer takes the position that the purchased option assigned to the charity is a § 1256 contract, the taxpayer relies on § 1256(c) and Greene v. United States, 79 F.3d 1348 (2d Cir. 1996) to mark to market the purchased option when the option is assigned to the charity and to recognize a loss at that time. In contrast, because the taxpayer takes the position that the assumed written option is not a § 1256 contract, the taxpayer claims not to recognize gain attributable to the option premium. Specifically, the taxpayer claims that the charity's assumption of the option obligation does not cause the taxpayer to recognize gain and that the taxpayer also does not recognize gain either at the time the option expires or terminates or at any other time.

ANALYSIS

Although as a general matter the “Facts” portion of Notice 2003-81 correctly describes the transaction at issue, it includes an erroneous conclusion of law. The second sentence in the “Facts” portion of Notice 2003-81 states: “The currency is one in which positions are traded through regulated futures contracts, and the purchased options, therefore, are foreign currency contracts within the meaning of § 1256(g)(2)(A) of the Internal Revenue Code and §1256 contracts within the meaning of §1256(b).”

This sentence should have stated “The taxpayer takes the position that the purchased options are foreign currency contracts within the meaning of §1256(g)(2)(A) of the Internal Revenue Code and §1256 contracts within the meaning of §1256(b).” The Service and Treasury do not believe that foreign currency options, whether or not the underlying currency is one in which positions are traded through regulated futures contracts, are foreign currency contracts as defined in §1256(g)(2), and intend to challenge any such characterization by taxpayers.

Section 1256(g)(2)(A) defines a foreign currency contract, in part, as a contract that requires delivery of, *or the settlement of which depends on the value of*, certain foreign currencies. The original statutory definition, however, did not allow for cash settlement and required actual delivery of the underlying foreign currency in all circumstances. Options, by their nature, only require delivery if the option is exercised. Section 102 of the Tax Reform Act of 1984, P.L. 98-369, 1984-3 (Vol. 1) C.B. 128, added the clause “or the settlement of which depends on the value of.” There is no indication, however, that Congress intended by this addition to extend the definition of “foreign currency contract” to foreign currency options. That conclusion is confirmed by the legislative history to § 988(c)(1)(E), enacted by the Technical and Miscellaneous Revenue Act of 1988, P.L. 100-647, 1988-3 C.B. 377-380, which indicates that a foreign currency option is not a foreign currency contract as defined in §1256(g)(2).

Subject to the following, §7805(b) relief is granted to taxpayers that adopted an accounting method in reasonable reliance on Notice 2003-81 to treat over-the-counter foreign currency options as foreign currency contracts as defined in §1256(g)(2). Section 7805(b) relief is not granted with respect to options entered into in transactions that are the same or substantially the same as those described in Notice 2003-81.

Further, §7805(b) relief is not granted with respect to options entered into in any transaction identified as a listed transaction for purposes of §§ 1.6011-4(b)(2), 301.6111-2(b)(2) and 301.6112-1(b)(2).

The principal authors of this notice are Mark E. Erwin of the Office of Associate Chief Counsel (International) and Patrick E. White of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this notice contact Mark E. Erwin at (202) 622-3870 or Patrick E. White at (202) 622-3920 (not a toll free call).

Internal Revenue Bulletin: 2008-2

January 14, 2008

Notice 2008-2

Timing, Character, Source and Other Issues Respecting Prepaid Forward Contracts and Similar Arrangements

Table of Contents

SECTION 1. PURPOSE

The purpose of this notice is to request comments from the public with respect to issues that arise in connection with certain financial transactions frequently referred to in the marketplace as prepaid forward contracts (or in certain circumstances as exchange traded notes).

SECTION 2. BACKGROUND

The Internal Revenue Service and the Treasury Department are considering the tax policy issues raised by certain financial transactions frequently referred to in the marketplace as prepaid forward contracts (or in certain circumstances as exchange traded notes). These transactions resemble typical forward contracts (that is, bilateral, executory contracts in which one party agrees to purchase an asset on a future date for a specific forward purchase price, payable at that future time), but the purchase price is paid in advance of future delivery or cash settlement. Thus, these transactions typically involve an initial payment by one party in exchange for a promise of either (i) a future delivery of a particular asset or group of assets (for example, stocks or commodities), or (ii) a future payment determined exclusively by reference to the value of such assets.

In particular, the Internal Revenue Service and the Treasury Department are considering whether the parties to such a transaction should be required to accrue income/expense during the term of the transaction, if the transaction is not otherwise indebtedness for U.S. federal income tax purposes. *See* Rev. Rul. 2008-1, 2008-2 I.R.B. , dated January 14, 2008 (holding that an instrument resembling, in form, a prepaid forward contract is debt). The Internal Revenue Service and the Treasury Department are also considering a number of other issues associated with these transactions, including:

- The appropriate methodology for accruing income or expense, if that is deemed appropriate (for example, a mark-to-market methodology or a method resembling the noncontingent bond method set forth in §1.1275-4 of the Income Tax Regulations);
- How an accrual regime might be designed so that it does not inappropriately or inadvertently cover routine commercial transactions involving property sales in the ordinary channels of commerce;
- The appropriate character (capital vs. ordinary, and if ordinary, whether interest) of any income accruals required under such an accrual regime, as well as the character of amounts less than, or in excess of, these accruals;
- Whether the tax treatment of the transactions should vary depending on the nature of the underlying asset (for example, stocks vs. commodities);
- Whether the tax treatment of the transactions should vary depending on whether the transactions are (i) executed on a futures exchange (and are not otherwise subject to section 1256 of the Internal Revenue Code), or (ii) memorialized in an instrument that is traded on a securities exchange;
- Whether the transactions should be treated as indebtedness pursuant to regulations issued under section 7872;
- Whether section 1260 applies, or should apply, to prepaid forward contracts and similar transactions;
- The degree to which such transactions (and any income accruals that may be mandated) should be taxed under sections 871 and 881;
- How the income with respect to such instruments should be treated for purposes of section 954 (for example, as income equivalent to interest or gains from property that does not give rise to income);
- How investments in such contracts should be treated under section 956;
- Whether there are other issues that should be considered with respect to these transactions (for example, whether short term transactions should be subject to the accrual regime);
- Identifying arrangements similar to prepaid forward contracts that should be accorded tax treatment similar to that of prepaid forward contracts; and
- Appropriate transition rules and effective dates.

SECTION 3. REQUEST FOR COMMENTS

The Internal Revenue Service and the Treasury Department request public comments with respect to the issues described in Section 2 of this notice.Comments must be submitted by May 13, 2008. All materials submitted will be available for public inspection and copying. Comments may be submitted to Internal Revenue Service, CC:PA:LPD:RU (Notice 2008-2), Room 5203, PO Box 7604, Ben Franklin Station, Washington, D.C. 20044. Submissions may also be hand-delivered Monday through Friday between the hours of 8:00 a.m. and 4:00 p.m. to the Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224, Attn: CC:PA:LPD:RU (Notice 2008-2), Room 5203. Submissions may also be sent electronically via the internet to the following email address: *Notice.Comments@irscounsel.treas.gov*. Include the notice number (Notice 2008-2) in the subject line.

DRAFTING INFORMATION

The principal author of this notice is John W. Rogers III of the Office of the Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice, contact Mr. Rogers at (202) 622-3950 (not a toll-free call).

More Internal Revenue Bulletins

Notice 2014-21

SECTION 1. PURPOSE

This notice describes how existing general tax principles apply to transactions using virtual currency. The notice provides this guidance in the form of answers to frequently asked questions.

SECTION 2. BACKGROUND

The Internal Revenue Service (IRS) is aware that "virtual currency" may be used to pay for goods or services, or held for investment. Virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value. In some environments, it operates like "real" currency -- i.e., the coin and paper money of the United States or of any other country that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance -- but it does not have legal tender status in any jurisdiction.

Virtual currency that has an equivalent value in real currency, or that acts as a substitute for real currency, is referred to as "convertible" virtual currency. Bitcoin is one example of a convertible virtual currency. Bitcoin can be digitally traded between users and can be purchased for, or exchanged into, U.S. dollars, Euros, and other real or virtual currencies. For a more comprehensive description of convertible virtual currencies to date, see Financial Crimes Enforcement Network (FinCEN) *Guidance on the Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies* (FIN-2013-G001, March 18, 2013).

SECTION 3. SCOPE

In general, the sale or exchange of convertible virtual currency, or the use of convertible virtual currency to pay for goods or services in a real-world economy transaction, has tax consequences that may result in a tax liability. This notice addresses only the U.S. federal tax consequences of transactions in, or transactions that use, convertible virtual currency, and the term "virtual currency" as used in Section 4 refers only to convertible virtual currency. No inference should be drawn with respect to virtual currencies not described in this notice.

The Treasury Department and the IRS recognize that there may be other questions regarding the tax consequences of virtual currency not addressed in this notice that warrant consideration. Therefore, the Treasury Department and the IRS request comments from the public regarding other types or aspects of virtual currency transactions that should be addressed in future guidance.

Comments should be addressed to:

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2014-21)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

or hand delivered Monday through Friday between the hours of 8 A.M. and 4 P.M. to:

Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2014-21)
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Alternatively, taxpayers may submit comments electronically via e-mail to the following address: Notice.Comments@irscounsel.treas.gov. Taxpayers should include "Notice 2014-21" in the subject line. All comments submitted by the public will be available for public inspection and copying in their entirety.

For purposes of the FAQs in this notice, the taxpayer's functional currency is assumed to be the U.S. dollar, the taxpayer is assumed to use the cash receipts and disbursements method of accounting and the taxpayer is assumed not to be under common control with any other party to a transaction.

SECTION 4. FREQUENTLY ASKED QUESTIONS

Q-1: How is virtual currency treated for federal tax purposes?

A-1: For federal tax purposes, virtual currency is treated as property. General tax principles applicable to property transactions apply to transactions using virtual currency.

Q-2: Is virtual currency treated as currency for purposes of determining whether a transaction results in foreign currency gain or loss under U.S. federal tax laws?

A-2: No. Under currently applicable law, virtual currency is not treated as currency that could generate foreign currency gain or loss for U.S. federal tax purposes.

Q-3: Must a taxpayer who receives virtual currency as payment for goods or services include in computing gross income the fair market value of the virtual currency?

A-3: Yes. A taxpayer who receives virtual currency as payment for goods or services must, in computing gross income, include the fair market value of the virtual currency,

measured in U.S. dollars, as of the date that the virtual currency was received. See Publication 525, *Taxable and Nontaxable Income,* for more information on miscellaneous income from exchanges involving property or services.

Q-4: What is the basis of virtual currency received as payment for goods or services in Q&A-3?

A-4: The basis of virtual currency that a taxpayer receives as payment for goods or services in Q&A-3 is the fair market value of the virtual currency in U.S. dollars as of the date of receipt. See Publication 551, *Basis of Assets,* for more information on the computation of basis when property is received for goods or services.

Q-5: How is the fair market value of virtual currency determined?

A-5: For U.S. tax purposes, transactions using virtual currency must be reported in U.S. dollars. Therefore, taxpayers will be required to determine the fair market value of virtual currency in U.S. dollars as of the date of payment or receipt. If a virtual currency is listed on an exchange and the exchange rate is established by market supply and demand, the fair market value of the virtual currency is determined by converting the virtual currency into U.S. dollars (or into another real currency which in turn can be converted into U.S. dollars) at the exchange rate, in a reasonable manner that is consistently applied.

Q-6: Does a taxpayer have gain or loss upon an exchange of virtual currency for other property?

A-6: Yes. If the fair market value of property received in exchange for virtual currency exceeds the taxpayer's adjusted basis of the virtual currency, the taxpayer has taxable gain. The taxpayer has a loss if the fair market value of the property received is less than the adjusted basis of the virtual currency. See Publication 544, *Sales and Other Dispositions of Assets*, for information about the tax treatment of sales and exchanges, such as whether a loss is deductible.

Q-7: What type of gain or loss does a taxpayer realize on the sale or exchange of virtual currency?

A-7: The character of the gain or loss generally depends on whether the virtual currency is a capital asset in the hands of the taxpayer. A taxpayer generally realizes capital gain or loss on the sale or exchange of virtual currency that is a capital asset in the hands of the taxpayer. For example, stocks, bonds, and other investment property are generally capital assets. A taxpayer generally realizes ordinary gain or loss on the sale or exchange of virtual currency that is not a capital asset in the hands of the taxpayer. Inventory and other property held mainly for sale to customers in a trade or

business are examples of property that is not a capital asset. See Publication 544 for more information about capital assets and the character of gain or loss.

Q-8: Does a taxpayer who "mines" virtual currency (for example, uses computer resources to validate Bitcoin transactions and maintain the public Bitcoin transaction ledger) realize gross income upon receipt of the virtual currency resulting from those activities?

A-8: Yes, when a taxpayer successfully "mines" virtual currency, the fair market value of the virtual currency as of the date of receipt is includible in gross income. See Publication 525, *Taxable and Nontaxable Income*, for more information on taxable income.

Q-9: Is an individual who "mines" virtual currency as a trade or business subject to self-employment tax on the income derived from those activities?

A-9: If a taxpayer's "mining" of virtual currency constitutes a trade or business, and the "mining" activity is not undertaken by the taxpayer as an employee, the net earnings from self-employment (generally, gross income derived from carrying on a trade or business less allowable deductions) resulting from those activities constitute self-employment income and are subject to the self-employment tax. See Chapter 10 of Publication 334, *Tax Guide for Small Business*, for more information on self-employment tax and Publication 535, *Business Expenses,* for more information on determining whether expenses are from a business activity carried on to make a profit.

Q-10: Does virtual currency received by an independent contractor for performing services constitute self-employment income?

A-10: Yes. Generally, self-employment income includes all gross income derived by an individual from any trade or business carried on by the individual as other than an employee. Consequently, the fair market value of virtual currency received for services performed as an independent contractor, measured in U.S. dollars as of the date of receipt, constitutes self-employment income and is subject to the self-employment tax. See FS-2007-18, April 2007, *Business or Hobby? Answer Has Implications for Deductions,* for information on determining whether an activity is a business or a hobby.

Q-11: Does virtual currency paid by an employer as remuneration for services constitute wages for employment tax purposes?

A-11: Yes. Generally, the medium in which remuneration for services is paid is immaterial to the determination of whether the remuneration constitutes wages for employment tax purposes. Consequently, the fair market value of virtual currency paid as wages is subject to federal income tax withholding, Federal Insurance Contributions

Act (FICA) tax, and Federal Unemployment Tax Act (FUTA) tax and must be reported on Form W-2, *Wage and Tax Statement*. See Publication 15 (Circular E), *Employer's Tax Guide*, for information on the withholding, depositing, reporting, and paying of employment taxes.

Q-12: Is a payment made using virtual currency subject to information reporting?

A-12: A payment made using virtual currency is subject to information reporting to the same extent as any other payment made in property. For example, a person who in the course of a trade or business makes a payment of fixed and determinable income using virtual currency with a value of $600 or more to a U.S. non-exempt recipient in a taxable year is required to report the payment to the IRS and to the payee. Examples of payments of fixed and determinable income include rent, salaries, wages, premiums, annuities, and compensation.

Q-13: Is a person who in the course of a trade or business makes a payment using virtual currency worth $600 or more to an independent contractor for performing services required to file an information return with the IRS?

A-13: Generally, a person who in the course of a trade or business makes a payment of $600 or more in a taxable year to an independent contractor for the performance of services is required to report that payment to the IRS and to the payee on Form 1099-MISC, *Miscellaneous Income*. Payments of virtual currency required to be reported on Form 1099-MISC should be reported using the fair market value of the virtual currency in U.S. dollars as of the date of payment. The payment recipient may have income even if the recipient does not receive a Form 1099-MISC. See the Instructions to Form 1099-MISC and the General Instructions for Certain Information Returns for more information. For payments to non-U.S. persons, see Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities*.

Q-14: Are payments made using virtual currency subject to backup withholding?

A-14: Payments made using virtual currency are subject to backup withholding to the same extent as other payments made in property. Therefore, payors making reportable payments using virtual currency must solicit a taxpayer identification number (TIN) from the payee. The payor must backup withhold from the payment if a TIN is not obtained prior to payment or if the payor receives notification from the IRS that backup withholding is required. See Publication 1281, *Backup Withholding for Missing and Incorrect Name/TINs,* for more information.

Q-15: Are there IRS information reporting requirements for a person who settles payments made in virtual currency on behalf of merchants that accept virtual currency from their customers?

A-15: Yes, if certain requirements are met. In general, a third party that contracts with a substantial number of unrelated merchants to settle payments between the merchants and their customers is a third party settlement organization (TPSO). A TPSO is required to report payments made to a merchant on a Form 1099-K, *Payment Card and Third Party Network Transactions*, if, for the calendar year, both (1) the number of transactions settled for the merchant exceeds 200, and (2) the gross amount of payments made to the merchant exceeds $20,000. When completing Boxes 1, 3, and 5a-1 on the Form 1099-K, transactions where the TPSO settles payments made with virtual currency are aggregated with transactions where the TPSO settles payments made with real currency to determine the total amounts to be reported in those boxes. When determining whether the transactions are reportable, the value of the virtual currency is the fair market value of the virtual currency in U.S. dollars on the date of payment.

See The Third Party Information Reporting Center, http://www.irs.gov/Tax-Professionals/Third-Party-Reporting-Information-Center, for more information on reporting transactions on Form 1099-K.

Q-16: Will taxpayers be subject to penalties for having treated a virtual currency transaction in a manner that is inconsistent with this notice prior to March 25, 2014?

A-16: Taxpayers may be subject to penalties for failure to comply with tax laws. For example, underpayments attributable to virtual currency transactions may be subject to penalties, such as accuracy-related penalties under section 6662. In addition, failure to timely or correctly report virtual currency transactions when required to do so may be subject to information reporting penalties under section 6721 and 6722. However, penalty relief may be available to taxpayers and persons required to file an information return who are able to establish that the underpayment or failure to properly file information returns is due to reasonable cause.

SECTION 5. DRAFTING INFORMATION

The principal author of this notice is Keith A. Aqui of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information about income tax issues addressed in this notice, please contact Mr. Aqui at (202) 317-4718; for further information about employment tax issues addressed in this notice, please contact Mr. Neil D. Shepherd at (202) 317- 4774; for further information about information reporting issues addressed in this notice, please contact Ms. Adrienne E. Griffin at (202) 317-6845; and for further information regarding foreign currency issues addressed in this notice, please contact Mr. Raymond J. Stahl at (202) 317- 6938. These are not toll-free calls.

OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

March 17, 2000

Number: **200025020**
Release Date: 6/23/2000
CC:DOM:FS:FI&P

UILC: 988.01-00
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR
ASSOCIATE DISTRICT COUNSEL

FROM: DEBORAH A. BUTLER
ASSISTANT CHIEF COUNSEL CC:DOM:FS

SUBJECT: Section 1256 Contracts and Section 988 Transactions

This Field Service Advice responds to your memorandum dated November 23, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

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ISSUES

1. Whether A traded regulated futures contracts ("RFCs") as defined in I.R.C. §§ 1256(b)(1) and 1256(g)(1).

2. What constitutes a foreign currency contract as defined in § 1256(g)(2).

3. Whether foreign currency option contracts that are not traded on a qualified board or exchange are foreign currency contracts under § 1256(g)(2).

4. Whether losses incurred on I.R.C. § 988 transactions may affect the taxpayers' net operating losses ("NOLs") pursuant to I.R.C. § 172.

5. What is the effect of A's status as a shareholder in C on his transactions in foreign currency futures, forwards and options.

6. Whether the taxpayers have properly amended their Tax Court petition.

CONCLUSIONS

1. A may have traded in RFCs as defined in §§ 1256(b)(1) and 1256(g)(1). Additional factual development is required.

2. A foreign currency contract may include a non-regulated foreign currency futures contract and a forward contract in foreign currency traded on the interbank market.

3. Foreign currency option contracts are not foreign currency contracts pursuant to § 1256(g)(2). Transactions in these contracts may qualify as § 988

transactions. The gains or losses on foreign currency options contracts that are not nonequity options will be characterized as ordinary gains or losses, pursuant to § 988(c)(1)(B)(iii).

4. To the extend that A was in the trade or business of engaging in § 988 transactions, any losses incurred could affect the taxpayers' NOL.

5. If C is viewed as an agent of A, its trading activity may be aggregated with A's activity in determining whether he was a trader or investor.

6. The taxpayers have properly amended their Tax Court petition in this case to raise the new issues with respect to the carryforward to the Year 3 tax year of NOLs allegedly incurred by the taxpayers in the Year 1 through Year 2 tax years.

FACTS

A is the taxpayer. From Year 1 through Year 2, A engaged in various types of trading[1] in foreign currency contracts. On their tax returns for these years, the taxpayer and B (collectively referred to as the "taxpayers") with whom he filed jointly, identified these contracts as "§ 1256 contracts", and marked to market the contracts which resulted in capital gains and losses.

On Date 2, the Service issued the taxpayers a Statutory Notice of Deficiency for their tax year ended Date 1. The Service determined that the taxpayers had a deficiency of $N, and disallowed their charitable deductions totaling $O claimed on their return.

On Date 3, the taxpayers filed a Petition in the Tax Court, challenging the deficiencies in the Statutory Notice.

On Date 4, the taxpayers filed an Amended Petition in the Tax Court. In this Amended Petition, the taxpayers argued that they had erroneously treated the foreign currency gains and losses as capital gains and losses on their Year 1 through Year 2 tax returns, and that the Commissioner failed to allow the taxpayers to deduct an NOL carryforward deduction under § 172 in the amount of $S in their Year 3 tax year. The taxpayers stated in the Amended Petition that A engaged in "§ 988 transactions" pursuant to § 988(b)(3). As a result, the gains and losses from his trading in options, forwards, futures and swap contracts in foreign currency from

[1] We use the words "trading" and "trader" here for convenience only.

Year 1 through Year 2 constituted ordinary gains and losses.[2] They allegedly incurred NOLs in the amount of approximately $P. The first time that these issues were raised was by the taxpayers in the Amended Petition.

The taxpayers argued that the trading activities conducted by A and C, a subchapter S corporation wholly owned by A, on A's behalf, resulted in a NOL in the amount of $Q in Year 1 which was available for either carrying back for three years or for carrying forward to subsequent taxable years. C owned a seat on the E.

On Date 5, the taxpayers filed a Second Amendment to Petition ("Second Amendment") with the Tax Court. In this Second Amendment, the taxpayers argued that, to the extent that C's gains and losses in foreign currency forwards, futures, options or swaps are not ordinary under § 988, such gains and losses are properly treated as ordinary income or loss because C was a "dealer", and a dealer's gains and losses are ordinary income under I.R.C. § 1221(1) or I.R.C. § 1234(b)(3). The taxpayers also argued that income or losses that they received from D, a partnership, were erroneously reported as capital gains and losses on their return.

The taxpayers' Year 1 through Year 2 tax years have not been audited. The Service did not determine a deficiency for the taxpayers' Year 1 through Year 2 tax years on the issue of the § 1256 contracts.

LAW AND ANALYSIS

Issue 1

I.R.C. § 1256 requires mark-to-market treatment for any "§ 1256 contract," defined in § 1256(b) as: (1) any regulated futures contact ("RFC"), (2) any foreign currency contract, (3) any nonequity option, and (4) any dealer equity option. Each § 1256 contract is marked to market on the last business day of each taxable year, and any gain or loss is then taken into account. I.R.C. § 1256(a)(1). Of the gain or loss realized by the taxpayer with respect to a § 1256 contract, 40% is treated as short-term capital gain or loss, and 60% is treated as long-term capital gain or loss. I.R.C. § 1256(a)(3)(A) and (B).

However, mark-to-market treatment under § 1256(a) does not apply to a § 1256 contract that is a hedge clearly identified before the close of the day on which the taxpayer entered into the transaction. I.R.C. § 1256(e). Capital gains treatment is

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[2] We identify A's transactions here as "futures" and "forwards" for convenience only.

denied for property that the taxpayer identified as being part of a hedging transaction under § 1256(e)(2)(C).

Section 1256(a)(3) does not apply to any gain or loss which, but for that provision, would be ordinary income or loss. I.R.C. § 1256(f)(2). Gain or loss from trading in a § 1256 contract is treated as gain or loss from the sale or exchange of a capital asset, unless if the contract is held as a hedge. I.R.C. § 1256(f)(3)(A) and (B). Additionally, whether a taxpayer is actively engaged in dealing in or trading § 1256 contracts is not taken into account for purposes of determining whether the gain or loss with respect to property related to the § 1256 contract is ordinary income or loss. I.R.C. § 1256(f)(3)(C).

An RFC is defined in § 1256(g)(1) as a contract (A) with respect to which the amount required to be deposited and the amount which may be withdrawn depends on a system of marking to market, and (B) which is traded on or subject to the rules of a qualified board or exchange. A qualified board or exchange includes a domestic board of trade designated as a contract market by the Commodities Futures Trading Commission ("CFTC"), or any other exchange, board of trade, or other market which the Secretary determines has rules adequate to carry out the purposes of this section. I.R.C. § 1256(g)(7)(B) and (C).

In its Annual Report to Congress, Futures and Option Contract Designations, the CFTC lists the markets and boards of trade that it has designated as "contract markets" and the commodities for which the markets or boards of trade are designated. The CFTC has jurisdiction to regulate the commodities futures markets. 7 U.S.C. §§ 1a, 2. The CFTC regulates transactions in foreign currency conducted on a board of trade. 7 U.S.C. §2(ii). The CFTC has the jurisdiction to designate a board of trade and an exchange as a contract market. 7 U.S.C. §§ 2a, 7.

A futures contract is not defined in § 1256. The CFTC defines a futures contract as "an agreement to purchase or sell a commodity for delivery in the future: (1) at a price that is determined at initiation of the contract; (2) which obligates each party to the contract to fulfill the contract at the specified price; (3) which is used to assume or shift price risk; and (4) which may be satisfied by delivery or offset." See CFTC Glossary: A Layman's Guide to the Language of the Futures Industry.

Only a futures contract for a designated foreign currency that has actually been traded on a CFTC designated contract market or subject to its rules is an RFC for purposes of § 1256(g)(1).[3] An RFC can be traded by either a taxpayer as a

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[3] The Secretary has determined that only certain exchanges or boards of trade have rules adequate to carry out the purpose of this section. See Rev. Rul. 85-72, 1985-1 C.B. 286; Rev. Rul. 86-7, 1986-1 C.B. 295; Rev. Rul. 86-8, 1986-1 C.B. 295.

principal or by a third party acting on the taxpayer's behalf as an agent. See, e.g., 17 C.F.R. § 1.2. Thus, futures contracts that have been traded by two private parties "over the counter" ("OTC") are not traded on a contract market and are not RFCs for purposes of § 1256(g)(1). See Rev. Rul. 87-43, 1987-1 C.B. 252. A futures contract that does not meet these terms may be a non-regulated futures contract.

The taxpayers have made additional arguments to support the position that A did not trade RFCs, but, rather, non-regulated futures contracts.

First, they argued that a number of the entities with whom A traded were not registered futures commission merchants ("FCMs") pursuant to 7 U.S.C. § 1a(12) and were not qualified to solicit or accept futures orders on a contract market; therefore, the futures were not RFCs. A firm or a person must be a registered FCM as defined under 7 U.S.C. § 1a(12) and 17 C.F.R. § 3.10, in order to solicit or accept futures contract orders on a contract market.[4]

Whether the counterparties were FCMs is not necessarily relevant to our inquiry because the remedy for any such violation is not one that causes a regulated futures contract to become unregulated. We do not have a complete list of all of the counterparties with whom A traded. Of the counterparties that we know, only L and M are FCMs. We recommend additional factual development, as discussed below.

Second, a trader in futures who holds more than 200 reportable positions in foreign currency contracts at the close of the market on a business day on a contract market is required to file a Form 40, "Statement of Reporting Trader" with the CFTC, pursuant to 17 C.F.R. §§ 18.04, 15.00, 15.03. Because A did not file a Form 40, the taxpayers argued that the futures that he traded were not RFCs.

Whether this required form was filed by A is not relevant to our inquiry because the remedy for any such failure to file is not one that causes an RFC to become unregulated.

Third, the taxpayers argued that the confirmation slips ("confirms") that A received from his counterparties did not conform with the formal documentation requirements established by 17 C.F.R. §1.35. Whether the counterparties complied with this requirement is not relevant to our inquiry because the remedy for any such violation would not cause an RFC to become unregulated.

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[4] A list of FCMs is publicly available from the National Futures Association through its internet site, http://www.nfa.futures.org/.

Fourth, the taxpayers argued that RFCs must have: (1) an expiration date in one of four specific calendar months, March, June, September, and December; (2) the expiration date of the contract that will be the Friday before the third Wednesday of March, June, September, or December; (3) the expiration date in nine months or less after the date the contract was entered into. They argued that certain of A's futures contracts did not conform to these specifications; therefore, these futures contracts were not regulated.

We disagree with the taxpayer's assertion that all futures contracts must have these specifications to qualify as RFCs for purposes of § 1256(g)(1). The CFTC does not require each exchange to have identical specifications for each futures contract. Each exchange or board of trade has its own rules and regulations for contract specifications for each commodity that may be either identical to or different from the contract specifications for another commodity on another exchange's specifications.

A § 988 transaction is defined as a transaction described as entering into or acquiring any forward contract, futures contract, option or similar financial instrument if the amount which the taxpayer is entitled to receive or is required to pay by reason of such transaction is denominated in terms of a nonfunctional currency or by reference to the value of one or more nonfunctional currencies. I.R.C. § 988(c)(1)(A). Foreign currency gain or loss attributable to a § 988 transaction is ordinary gain or loss. I.R.C. § 988(a)(1).

For tax years prior to 1988 and for the taxable year 1988 for transactions entered into prior to October 22, 1988, RFCs were excluded from the definition of § 988 contracts because RFCs were marked to market under § 1256. I.R.C. § 988(c)(1)(B)(iii), as enacted in the Tax Reform Act of 1986, P.L. 99-514 § 1261(a). Accordingly, any RFC held during this period would be marked to market and any gain or loss realized on the RFC would be capital, unless § 1256(e) or (f) applied. I.R.C. § 1256(a)(1) and (3).

An RFC is not included in the definition of a § 988 transaction for transactions entered into, or contracts acquired, after October 21, 1988, pursuant to § 988(c)(1)(D), unless the taxpayer elected during that taxable year under § 988(c)(1)(D)(ii) to treat these transactions as § 988 transactions. If the taxpayers elected in the manner prescribed under § 988(c)(1)(D)(ii) and Treas. Reg. § 1.988-1(a)(7)(iii) to treat these transactions as § 988 contracts, then the taxpayers will receive ordinary gains or losses on those RFCs. We have no facts that indicate that the taxpayers elected to treat their RFCs as § 988 contracts.

Issue 2

A foreign currency contract is defined in § 1256(g)(2) as a contract-

> (i) which requires delivery of, or the settlement of which depends on the value of a foreign currency which is a currency in which positions are also traded through RFCs,
> (ii) which is traded in the interbank market, and
> (iii) which is entered into at arm's length at a price determined by reference to the price in the interbank market.

Congress equated foreign currency contracts (forward contracts) economically with RFCs. In the Committee Report, H. Rept. 97-794, 97th Cong., 2d Sess., 23 (1982), Congress stated the following:

> Foreign currency contracts.-- Trading in foreign currency for future delivery is conducted through regulated futures contracts, and is also conducted through contracts negotiated with any one of a number of commercial banks which comprise an informal market for such trading (bank forward contracts). Bank forward contracts differ from regulated futures contracts in that they are private contracts in which the parties remain entitled to performance from each other. They further differ from regulated futures contracts in that they do not call for daily variation margin to reflect market changes, and in that the interbank market has no mechanism for settlement terminating a taxpayer's position prior to the delivery date. Prior to ERTA, taxpayers who used both the futures exchanges and the interbank market to conduct short-term trading in foreign currency were subject to substantially comparable tax treatment for both types of contract. Although bank forward contracts differ from regulated futures contracts, the volume of trading through forward contracts in foreign currency in the interbank market is substantially greater than foreign currency trading on futures exchanges, and prices are readily available. Such contracts are economically comparable to regulated futures contracts in the same currencies and are used interchangeably with regulated futures contracts by traders.

Congress intended to include within the definition of a foreign currency contract bank forward contracts in currencies that are traded through RFCs because bank forward contracts are economically comparable to and used interchangeably with RFCs. A non-regulated futures contract is economically comparable to both an RFC and a bank forward contract; therefore, a non-regulated futures contract may qualify as a foreign currency contract.

One expert has explained a forward contract as:

> similar to a futures contract in that it contemplates delivery of a specified quantity of goods, at a specified price, at some

> specified date in the future. Forward contracts differ, however, because they are private contracts in which the parties remain entitled to performance from each other. No organized market or established mechanism is available for terminating a taxpayer's position prior to the delivery date. . . . In addition, the terms of a forward contract are usually not standardized. . . .

Kevin M. Keyes, Federal Taxation of Financial Instruments and Transactions, ¶13.03[2][a] (Warren Gorham & Lamont)(1997).

The Internal Revenue Code offers no definition of the interbank market. The interbank market refers to the OTC market maintained by banks to purchase and sell foreign currency and financial products. The interbank market is not a formal market, but rather a group of banks holding themselves out to the general public as being willing to purchase, sell or otherwise enter into certain transactions. The Service broadly interprets the interbank market to include all banks and investment banks (as the terms are generally used in the marketplace). We conclude that the parties with whom A traded foreign currency forward contracts (F, G, H, I, J, and K) were members of the interbank market.

Foreign currency futures contracts that do not qualify as RFCs under § 1256(g)(1) but do qualify as foreign currency contracts under § 1256(b)(2) and (g)(2) will be marked to market pursuant to § 1256(a)(1). For tax years prior to 1988, and for the taxable year 1988 for transactions entered into prior to October 22, 1988, all non-regulated futures and forward contracts that were marked to market pursuant to § 1256(b)(2) were excluded from the definition of a § 988 contract.

Foreign currency contracts acquired or entered into after October 21, 1988, that were § 1256 contracts will be treated as both § 1256 contracts and § 988 transactions. Section 1256(f)(2) provides an exception from capital treatment for income that, but for § 1256(a)(3), would be ordinary. The losses will be characterized as ordinary losses unless the taxpayer elected out of ordinary treatment, pursuant to § 988(a)(1)(B) and Treas. Reg. § 1.988-3(b)(4). In order for an election to be valid, a verification statement must be attached to the return. We have no facts that indicate that the taxpayers made this election.

A foreign currency forward contract that was not a § 1256 contract may qualify as a § 988 contract pursuant to § 988(c)(1)(B)(iii) for all tax years at issue. Accordingly, for all of the taxable years at issue, losses incurred on these contracts are characterized as ordinary losses under § 988(a)(1)(A).

Issue 3

Although the definition of a foreign currency contract provided in § 1256(g)(2) may be read to include a foreign currency option contract, the legislative history of the

Technical Corrections Act of 1982 ("TCA"), Pub. L. No. 97-448, 1983-1 C.B. 451, which amended § 1256 to include foreign currency contracts, indicates that the Congress intended to extend § 1256 treatment only to foreign currency forward contracts that are traded on the interbank market. See S. Rep. No. 592, 97th Cong., 2d Sess., reprinted in 1983-1 C.B. 475, 485-486; H.R. Rep. No. 986, 97th Cong., 2d Sess., reprinted in 1983-1 C.B. 498, 503-04. There is no indication that foreign currency option contracts were contemplated for inclusion in the statutory definition of a forward currency contract in § 1256(g)(2)(A).

Sections 1256(g)(3) and (4) deal comprehensively with options listed on a qualified board or exchange. These provisions were added to the Code by section 102(a)(3) of the Tax Reform Act of 1984 ("TRA"), Pub. L. No. 98-369, 1984-3 (Vol. 1) C.B. 128. They provide that only dealer equity options (i.e., listed stock options) and listed options (other options listed on exchanges) are § 1256 contracts.[4] The legislative history to these provisions is silent regarding whether the failure to separately include a provision addressing the treatment of foreign currency options was due to their having been included within § 1256(g)(2)(A).

The legislative history to section 722(a)(2) of the TRA, however, which amended § 1256(g)(2), indicates that only "certain" foreign currency contracts were treated as regulated futures contracts under that provision. See H.R. Rep. No. 432, 98th Cong., 2d Sess. 1646 (1984). This, coupled with the previously referenced provisions of the legislative history to the TCA, and our view that reading § 1256(g)(2) expansively to apply generally to foreign currency options would effectively override the limitations of § 1256(g)(3) and (4), leads us to conclude that foreign currency option contracts are not foreign currency contracts pursuant to § 1256(g)(2)(A).

Losses on foreign currency options that do not qualify as nonequity options under § 1256(g)(3) will be treated as § 988 transactions, for which the gains or losses will be ordinary.

Issue 4

For an individual or other qualified noncorporate taxpayer, an NOL is determined under § 172(c) by subtracting gross income from the allowable income tax deductions and applying the relevant modifications of § 172(d). See Treas. Reg. § 1.172-3(a). Among these modifications, under § 172(d)(2)(A), the deduction of any nonbusiness capital loss is limited to the amount of capital gain; consequently, any excess of capital losses over capital gains cannot, by definition, create or

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[4] A listed option is traded on or subject to the rules of a qualified board or exchange under § 1256(g)(5) and (g)(7) to the same extent that an RFC is traded on or subject to the rules of a qualified board or exchange. See discussion, infra, at 5-6.

increase an NOL. In this context, it should also be remembered that capital losses and capital gains remain such irrespective of whether these amounts are long-term or short-term (i.e., taxation rates are distinguished from the character of the income).

Section 172(d)(4) limits the use of nonbusiness deductions in the computation and deems any gain or loss on the sale of a business property (i.e., real property or other property used in the trade or business and subject to the depreciation allowance of § 167) as attributable to that trade or business.

Under the § 172(d) modifications, each taxpayer is considered to have two general categories of income: business income and nonbusiness income. Similarly, there are two corresponding categories of deductions: business deductions and nonbusiness deductions. To apply the modifications correctly, therefore, a taxpayer's income items and deductions must be appropriately characterized as either attributable or not attributable to a trade or business. Nonbusiness deductions, like capital losses, have no effect on an NOL, except to the extent they absorb nonbusiness income that would otherwise be applied against an NOL. The restrictions on nonbusiness deductions in making the modifications in computing an NOL often lead to the statement that such nonbusiness deductions end up "wasted." See, e.g., Malchin v. Commissioner, T.C. Memo. 1981-460.

Notwithstanding its critical nature for purposes of many other provisions, as well as § 172 here, the phrase "trade or business" has never been expressly defined by the Internal Revenue Code. In determining whether deductions and income are attributable to a taxpayer's trade or business for the purpose of the NOL rules of § 172, the term trade or business has been given the same meaning as it has under § 162. See Commissioner v. Polk, 276 F.2d 601 (10th Cir. 1960), aff'g 31 T.C. 412 (1958); Roberts v. Commissioner, 258 F.2d 634 (5th Cir. 1958), aff'g T.C. Memo. 1957-145; Todd v. Commissioner, 682 F.2d 207 (9th Cir. 1982), aff'g 77 T.C. 246 (1981); Wood v. Commissioner, 37 T.C. 70 (1961), acq. 1969-2 C.B. xxv.

The resolution of whether a taxpayer is engaged in a trade or business is always a highly factual determination. There are many cases setting out the general factors to be weighed in making that call in a variety of circumstances; yet, in the context of the specific choice presented here–the trader vs. investor dichotomy–there are numerous decided cases that should aptly guide that analysis.

The Supreme Court case of Higgins v. Commissioner, 312 U.S. 212 (1941), interpreting the predecessor provision to § 162 ("carrying on any business") and stressing that it was a case-by-case decision, did indeed find that the investment activity there, irrespective of how involved and continuous it was, should not be treated as a trade or business. It noted that the Commissioner had not, as yet, made any allowance for the "continuity, constant repetition, regularity, and extent" with which a particular activity was pursued so as to rise to a business. Id. at 215.

No such allowance on his part could be inferred. Id. At the same time, however, the Court did recognize that decisions of the lower courts in other cases had found such facts distinguishable and had ruled against the Commissioner in those cases, i.e., that the activity did rise to the level of carrying on a business. Id. at 216. The Court did not question the results in those case. See, e.g., Kales v. Commissioner, 101 F.2d 35, 39 (6th Cir. 1939) (holding its taxpayer within the scope, court said "there are cases where the activities of taxpayers are such that though they invest but their own capital they are none the less carrying on a business"). While the Court has since repeated its earlier statement that "investing is not a trade or business," Whipple v. Commissioner, 373 U.S. 193 (1963), in reality, that does not provide us a standard informing when trading activity, in itself, becomes a trade or business.

In a case quoted with approval by the Ninth Circuit in Purvis v. Commissioner, 530 F.2d 1332 (9th Cir. 1976), the Tax Court set forth this standard in attempting to distinguish between investing and trading:

> [I]n [investing], securities are purchased to be held for capital appreciation and income, usually without regard to short-term developments that would influence the price of securities on the daily market. In a trading account, securities are bought and sold with reasonable frequency in an endeavor to catch the swings in the daily market movements and profit thereby on a short-term basis.

Chang Hsiao Liang v. Commissioner, 23 T.C. 1040, 1043 (1955), acq. 1955-2 C.B. 4. See also Estate of Yaeger v. Commissioner, 889 F.2d 29, 33 (2d Cir. 1989).

Applying that Liang paragraph as the sole standard, A here may seem to meet the test for a trader, given the short term nature of his various security positions taken. In addition, no dividends are paid and long-term capital appreciation is usually unattainable with respect to foreign currency futures, forwards and options contracts.

To the extent that the Liang "holding" considerations are viewed as merely factors, rather than as a standard or test, to be weighed along with other factors noted in the other cases (e.g., the time, resources, and regularity dedicated to the purported trading activity), then labeling A here as a "trader" probably becomes much less compelling. Thus, in the same way, a finding that any losses are attributable to a business rather than "merely" capital losses for purposes of making the § 172(d) modifications is also less likely. Therefore, to the extent that A was in the trade or business of engaging in § 988 transactions, any losses incurred would affect the taxpayers' NOL. However, even if A were in the trade or business of trading § 1256 contracts, any gain or loss realized on these contracts would not reduce their NOL under § 172(d)(2)(A) because § 1256(f)(3)(A) specifically states that gain or loss

from trading in § 1256 contracts shall be treated as gain or loss from the sale or exchange of a capital asset.

Issue 5

Unless C is viewed as acting as an agent of A with respect to a trade, it will be viewed as a separate entity and its trading activity must be analyzed independently of the taxpayer. The determination must then be made whether either C or the A are traders or investors. If C is viewed as an agent of the taxpayer, its trading activity may be aggregated with A's trading activity in determining whether A is a trader or investor.

Thus, in determining whether A's trading activity was sufficiently regular and continuous so that the taxpayer would be considered a trader rather than an investor, those trades conducted through C will not be considered unless C is found to be an agent of the taxpayer. If C is not found to be the agent of A, its trading activity must be independently analyzed to determine whether it was sufficiently regular and continuous so that C would be considered a trader rather than investor.

Issue 6

Tax Court Rule 41(a) requires a party to obtain the leave of the court or the written consent of the opposing party before amending a pleading using the standard of whether "justice so requires." Unless the other party can show surprise, disadvantage, or prejudice, the court will generally allow a pleading to be amended at any time before a decision is filed. To avoid such surprise or disadvantage, the court is more likely to allow a pleading to be amended early in the trial process than after a case has been tried. Kroh v. Commissioner, 98 T.C. 383 (1992); Kramer v. Commissioner, 89 T.C. 1081 (1987).

The taxpayers were allowed to raise the new issue in this case when the court allowed them to file the First Amendment. Since then, the Service and the taxpayers have had the opportunity to develop that issue through informal and formal discovery. In the course of that development, taxpayers have apparently found records of additional transactions (the L trades) not reported on their return and were reminded that some trades had been made, not by A, but by D and C.

We are not aware of how many transactions must be examined in connection with the L trades, the D trades, or the C trades, but we understand that these transactions are of the same nature as the other trades undertaken by A directly. In fact, they may have been considered as A's trades in computing the overpayment claimed in the First Amendment to the petition. Since no trial date has been set and the taxpayers have provided access to the trade documentation, we can see no reason for objecting to the Second Amendment to clarify the legal issues before the court.

Under the doctrine of res judicata, the pending Tax Court case is the taxpayers' last opportunity for raising these issues with respect to the Year 3 tax year. A judgment on the merits for a particular tax year bars any subsequent proceedings for the same tax year. Commissioner v. Sunnen, 333 U.S. 591 (1948). If a party does not raise a claim or a defense in the first suit, the party is deemed to waive the right to raise that claim in a later suit. United States v. Shanbaum, 10 F.3d 305 (5th Cir. 1994). The doctrine applies whenever a decision is entered on the merits of a case, regardless of whether the case is settled or tried. Baptiste v. Commissioner, 29 F.3d 1533, 1539 (11th Cir. 1994), quoting United States v. International Building Co., 345 U.S. 502 (1953). Thus, if the taxpayers did not raise a claim to carry forward the losses to Year 3 in this case before filing a stipulated decision in settlement of the charitable deduction issue, they could not raise the losses in a later proceeding.

The court can consider the taxpayers' losses from Year 1 through Year 2 even though those years are not before the court and even though the limitations periods for assessing tax or claiming refunds for those years have expired. In determining the taxpayers' Year 3 tax liability, including overpayments, the court clearly has jurisdiction to consider transactions in other years that affect the Year 3 taxes.

Section 6214(b) gives the Tax Court jurisdiction —

> to consider such facts with relation to other years and other quarters as may be necessary correctly to redetermine the amount of [the deficiency for the year before the court], but in so doing shall have no jurisdiction to determine whether or not the tax for any other year has been overpaid or underpaid.

Thus, for example, when a taxpayer claims the benefits of the carryforward or carryback of an NOL or an investment credit to the year before the court, the court may consider whether the taxpayer actually incurred a loss or was entitled to an investment credit in the claimed amount in an unopen tax year and may consider the proper allocation of the NOL in other tax years before determining how much of the loss or credit is available in the year before the court. Leitgen v. Commissioner, 82-2 U.S.T.C. (CCH) ¶ 9553 (8th Cir. 1982), aff'g T.C. Memo. 1981-525; Phoenix Coal Co. Inc. v. Commissioner, 231 F.2d 420 (2d Cir. 1956), aff'g. T.C. Memo. 1955-28; Hill v. Commissioner, 95 T.C. 437 (1990); Lone Manor Farms, Inc. v. Commissioner, 61 T.C. 436, 440 (1974), aff'd without published opinion 510 F.2d 970 (3d Cir. 1975); ABKCO Industries, Inc. v. Commissioner, 56 T.C. 1083 (1971), aff'd on other grounds, 482 F.2d 150 (3d. Cir. 1973).

The court cannot determine taxes for a tax year not before the court, but it can consider adjustments to the tax for the year not before the court in determining the tax for the year over which it does have jurisdiction. Thus, in Leitgen, the Eighth Circuit upheld the Tax Court in allowing the Service to challenge the validity and the

amount of a loss claimed on the taxpayers' 1972 return in the process of determining the tax liability for 1973, even though the statute of limitations had run for the 1972 tax year.

In this case, the Tax Court can consider the losses claimed by the taxpayers for their Year 1 through Year 2 tax years in determining how much of such losses were available to be carried forward to the Year 3 tax year. The taxpayers will have the burden of convincing the court:

1) that they incurred losses from trading activities during Year 1 through Year 2;

2) that the losses were ordinary losses or § 988 losses rather than capital losses as initially reported on the taxpayers' returns;

3) that they actually incurred losses in the amounts they now claim;

4) that the losses would not have been exhausted in determining the correct tax liabilities in the years in which they were incurred or in other years to which they could have first been carried back or carried forward, but for which refunds are now barred by the statutory limitations periods; and

5) that the claimed losses were available for use in determining the taxpayers' Year 3 tax liability.

Realistically, because the Tax Court allowed the taxpayers to file the Amended Petition over the Service's objection on Date 4, we see no reason to object to the filing of the Second Amendment to the petition. The characterization of the taxpayers' trading losses is now before the court. We anticipate, once the Second Amendment to the petition is filed, that the Service will file the appropriate motion on the issue of whether the Tax Court has jurisdiction to consider the taxpayers' claimed recharacterization of the losses incurred, and reported as capital losses, by D and C. In the interim, Counsel will need to address the amount and characterization of the losses incurred directly by A.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[redacted]

[redacted]

Please call if you have any further questions.

JOEL E. HELKE, Chief
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Part III
Administrative, Procedural, and Miscellaneous

Announcement Requesting Comments on Foreign Contingent Debt

Announcement 99-76

I. Summary.

The Department of Treasury ("Treasury") and the Internal Revenue Service (the "Service") intend, in the near future, to withdraw the proposed regulations under section 988 regarding contingent payment debt instruments, dual currency debt instruments and multi-currency debt instruments and are considering how new proposed regulations under section 988 should treat these types of debt instruments. This announcement is intended to apprise taxpayers of the general approach currently being considered by Treasury and the Service with respect to the taxation of contingent payment debt instruments that provide for payments denominated in or determined by reference to a nonfunctional currency ("nonfunctional currency contingent instruments") and to request comments regarding the proper treatment of these instruments. This announcement also provides details regarding the specific rules under consideration and presents examples of the application of these rules to nonfunctional currency contingent instruments.

II. Background.

On March 17, 1992, Treasury and the Service issued proposed regulations §§ 1.988-1(a)(3),(4) and (5), regarding contingent payment debt instruments, dual currency debt instruments and multi-currency debt instruments. The proposed regulations followed the general approach in the then proposed § 1.1275-4(g) contingent payment debt regulations (LR-189-84, 51 F.R. 12022 (1986), amended FI-189-84 56 F.R. 8308 (1991)) and bifurcated debt instruments into contingent and noncontingent components. After an instrument was bifurcated, the proposed regulations applied the rules in § 1.988-1 through -5, as appropriate, to the resulting components.

On December 16, 1994, Treasury and the Service did not adopt the bifurcation approach by withdrawing the then proposed § 1.1275-4(g) regulations. At the same time, they proposed a new set of § 1.1275-4 regulations that adopted the “noncontingent bond method.” Under the noncontingent bond method, interest is accrued on the issue price of the instrument at a rate equal to the comparable yield. Such a yield is the yield at which an issuer would issue a fixed rate debt instrument with terms and conditions similar to those of the contingent payment debt instrument. The interest on the debt instrument is original issue discount and, therefore, is taken into account as it accrues, regardless of the taxpayer’s normal method of accounting. The comparable yield is used to construct a projected payment schedule for the debt instrument, which includes a projected amount for each contingent payment.

If the actual amount of a contingent payment is greater than the projected amount, the difference is additional interest. If the actual amount of a contingent payment is less than the projected amount, the difference generally offsets current interest accruals. In some cases, the difference may result in a loss to the holder and income to the issuer. The proposed § 1.1275-4 regulations were finalized on June 14, 1996.

Treasury and the Service believe that proposed regulations §§ 1.988-1(a)(3),(4) and (5) should now be withdrawn and reproposed since they incorporate the bifurcation approach rather than the noncontingent bond method ultimately adopted under § 1.1275-4. Treasury and the Service continue to believe that, for purposes of accounting for interest and principal on nonfunctional currency contingent instruments, the principles that govern the accounting for interest and principal of functional currency contingent payment debt instruments should apply. Treasury and the Service believe that providing a consistent set of rules in this area is in the best interests of taxpayers. In addition, Treasury and the Service are concerned that, in the absence of regulations requiring the application of the principles of § 1.1275-4 to nonfunctional currency contingent instruments, taxpayers can avoid the application of these principles by denominating contingent payment debt instruments in a nonfunctional currency.

III. General Approach Under Study.

Treasury and the Service generally believe that with respect to nonfunctional currency contingent instruments issued for money or publicly traded property, regulations should apply the principles of § 1.1275-4(b) in the nonfunctional currency and provide for the translation of interest and principal into functional currency by applying principles similar to those that apply under section 988 to instruments with original issue discount. As explained further below, application of § 1.1275-4(b) principles to nonfunctional currency contingent instruments generally would require taxpayers to (i) accrue interest in the nonfunctional currency at a yield at which the issuer would issue a fixed rate debt instrument denominated in the nonfunctional currency with terms and conditions similar to those of the nonfunctional currency contingent debt instrument, (ii) translate the interest accrued from the nonfunctional currency into the functional currency (and account for foreign exchange gain or loss) under the principles of section 988, and (iii) account for gain or loss arising from non-currency contingencies consistent with the rules of § 1.1275-4(b).

IV. Description of Instruments.

Treasury and the Service have identified three classes of instruments for which guidance is needed: (1) debt instruments for which all payments of principal and interest are denominated in, or determined by reference to, a single nonfunctional currency and which have one or more non-currency contingencies, (2) debt instruments for which payments of principal or interest are denominated in, or determined by

reference to, more than one currency and which have no non-currency contingencies, and (3) debt instruments for which payments of principal or interest are denominated in, or determined by reference to, more than one currency and which also have one or more non-currency contingencies. Throughout this announcement these instruments will be referred to as Class One, Class Two and Class Three instruments, respectively.

A. Class One Instruments.

1. In general.

Class One instruments are debt instruments for which all payments of principal and interest are denominated in, or determined by reference to, a single nonfunctional currency and which have one or more non-currency contingencies. For example, with respect to a taxpayer whose functional currency is the U.S. dollar, a debt instrument issued by the taxpayer is a Class One instrument if the instrument is denominated in British pounds and provides for a payment at maturity that is contingent on the value of the stock of an unrelated corporation.

Treasury and the Service are contemplating a regulatory approach that would apply the principles of § 1.1275-4(b) to Class One instruments issued for money or publicly traded property. Under this approach, taxpayers would accrue interest under the noncontingent bond method in the nonfunctional currency. For example, an issuer of the above-described debt instrument would first determine the comparable yield of the instrument, i.e., the yield at which the issuer would issue a fixed rate instrument in British pounds with terms and conditions similar to those of the instrument actually being issued. Second, the issuer would construct a projected payment schedule applying that yield. Third, the amount of interest accrued in each taxable year would be based on the comparable yield and translated into dollars under the principles of section 988. Fourth, the issuer and holders would account for differences between the projected amount of payments and the actual amount of payments (i.e., so-called "positive adjustments" and "negative adjustments") under rules similar to those in § 1.1275-4(b). Finally, foreign currency gain or loss would be determined with respect to accrued interest and principal. A more specific explanation of this approach and two examples of the potential application of these principles are set forth below.

Treasury and the Service are concerned that, under some circumstances, an issuer may have difficulties in determining the comparable yield at which it would issue a comparable nonfunctional currency fixed rate debt instrument. These difficulties may include a lack of adequate information about the yield at which the issuer could issue a comparable fixed rate debt instrument denominated in the nonfunctional currency with terms and conditions that are similar to those of the nonfunctional currency contingent instrument. Treasury and the Service request comments regarding this and other circumstances where computation of the comparable yield would be difficult and suggestions for addressing such circumstances.

2. Rules For Accrual and Translation.

(a) Accrual of interest and determination of positive and negative adjustments.

Pursuant to the approach under study, interest on a Class One instrument is accrued each taxable year in the nonfunctional currency at the comparable yield (determined in that nonfunctional currency) and translated into functional currency at the average exchange rate or, at the taxpayer's election, at the appropriate spot rate in accordance with the rules under § 1.988-2(b)(2)(iii)(B). A net positive adjustment, within the meaning of § 1.1275-4(b)(6), determined in the nonfunctional currency is treated as interest and translated from nonfunctional currency into the taxpayer's functional currency at the spot rate on the date the adjustment was taken into account.

A net negative adjustment, within the meaning of § 1.1275-4(b)(6), determined in nonfunctional currency first reduces interest that otherwise would be accrued by the taxpayer during the current tax year in the nonfunctional currency. Where a net negative adjustment exceeds the interest that otherwise would be accrued by the taxpayer during the current tax year in the nonfunctional currency, the excess is treated as an ordinary loss (if the taxpayer is a holder) or ordinary income (if the taxpayer is the issuer).

The amount treated as ordinary loss by a holder, however, is limited to the amount by which the holder's total interest inclusions on the debt instrument (determined in nonfunctional currency prior to translation into functional currency) exceed the total amount of the holder's net negative adjustments treated as ordinary loss on the debt instrument in prior taxable years (determined in nonfunctional currency). The amount treated as ordinary income by an issuer is limited to the amount by which the issuer's total interest deductions on the debt instrument (determined in nonfunctional currency prior to translation into functional currency) exceed the total amount of the issuer's net negative adjustments treated as ordinary income on the debt instrument in prior taxable years (determined in nonfunctional currency).

If the negative adjustment determined in nonfunctional currency exceeds the sum of the amounts treated as a reduction of interest income and as ordinary loss to the holder (or interest expense and ordinary income to the issuer) on the debt instrument for the taxable year, the excess is treated as a "negative adjustment carryforward" within the meaning of § 1.1275-4(b)(6). A negative adjustment carryforward arising in a year preceding the year of termination of the debt instrument is carried forward and treated as a negative adjustment denominated in nonfunctional currency in the immediately succeeding taxable year. A negative adjustment carryforward arising in the year of termination reduces (in the nonfunctional currency) the amount realized by the holder on such termination. For purposes of this reduction, both the negative adjustment carryforward and the amount realized are denominated in the nonfunctional currency. If an issuer has a negative adjustment carryforward in the year in which the debt

instrument is terminated, the issuer recognizes ordinary income equal to the amount of the unutilized carryforward (computed in the nonfunctional currency and translated into functional currency at the spot rate on the date the instrument was issued).

(b) Translation of adjustments.

After determining the amount of a positive or negative adjustment, it may be necessary to translate such amount into functional currency. As previously stated, a net positive adjustment is translated into functional currency at the spot rate on the date the adjustment is taken into account.

One of three principles may apply to address translation issues with respect to a negative adjustment, depending on whether the net negative adjustment is allocated to interest accrued in the current taxable year, interest accrued and not paid in a prior taxable year or interest accrued and paid in a prior taxable year. With respect to a net negative adjustment that reduces interest accrued in the current year in nonfunctional currency, neither the portion of the net negative adjustment so used nor the interest reduced by such adjustment is translated into functional currency. With respect to a net negative adjustment that reduces interest accrued but not paid in a prior year, the taxpayer translates such net negative adjustment from the nonfunctional currency into its functional currency at the rate used to account for those interest accruals. For this purpose, net negative adjustments are attributable to interest accrued in the immediately preceding taxable year (to the extent the accrued interest was not paid in such year) and thereafter to interest accrued but not paid in each preceding taxable year. With respect to a net negative adjustment that reduces interest accrued and paid in a prior taxable year, the taxpayer translates such net negative adjustment at the spot rate on the issue date or purchase date, if later. Any negative adjustment carryforward is carried forward in nonfunctional currency and applied to reduce interest in subsequent years.

In a year in which the instrument is sold, exchanged or otherwise terminated, any negative adjustment carryforward not applied to interest reduces the holder's amount realized in nonfunctional currency, and no translation is required. With respect to the issuer, in a year in which the instrument is terminated any negative adjustment carryforward not applied to interest results in ordinary income equal to the amount of the carryforward not utilized. Such amount is computed in the nonfunctional currency and translated into functional currency at the spot rate on the date the instrument was issued.

(c) Determination of basis.

In general, a holder computes basis adjustments in nonfunctional currency under the principles of § 1.1275-4(b)(7)(iii) and translates such adjustments into functional currency. Thus, the regulations would provide that a holder's basis in a Class One instrument is increased by the holder's accrued but unpaid interest inclusions on the debt instrument and decreased by the amount of any noncontingent payment and the projected amount of any contingent payment previously made on the debt instrument to the holder. Under this approach, these amounts, determined in nonfunctional currency, are translated under the principles of § 1.988-2(b).

(d) Determination of amount realized.

Under § 1.1275-4(b)(7)(iv), for purposes of determining the amount realized by a holder on the scheduled retirement of a contingent payment debt instrument, the holder is treated as receiving the projected amount of any contingent payment due at maturity. In addition, the holder's amount realized is reduced by any negative adjustment carryforward. For purposes of determining the repurchase price paid by the issuer on the scheduled retirement of a contingent payment debt instrument, the issuer is treated as paying the projected amount of any contingent payment due at maturity. Pursuant to the approach under study, these determinations would be made in the nonfunctional currency and would not take into account foreign currency gain or loss, which would be computed separately.

With respect to the holder, in the absence of a negative adjustment carryforward, the amount realized in nonfunctional currency is translated into functional currency by separating the amount realized into its component parts. Consistent with the principles of § 1.988-2(b)(7), the portion of the amount realized equal to accrued but unpaid interest is translated into functional currency at the same rate used to translate those accruals in the relevant years. The remainder of the projected payment is translated into functional currency at the same rate used to translate principal in the year of issuance or purchase. (Foreign currency gain or loss is computed separately as set forth below.) A negative adjustment carryforward is applied and translated into functional currency under the rules set forth above.

(e) Determination of foreign currency gain or loss.

Foreign currency gain or loss is determined on a Class One instrument with respect to principal and interest based on the comparable yield and projected payment schedule under the principles of § 1.988-2(b). Except with respect to a positive adjustment described in § 1.1275-4 (b)(9)(ii)(A), no foreign currency gain or loss is computed with respect to positive or negative adjustments.

(f) Source rules.

Any contingent gain characterized as interest is sourced under rules applicable to interest (i.e., sections 861(a)(1) and 862(a)(1)). Under Temp. Reg. § 1.865-1T(b)(2), losses by a holder from a contingent payment debt instrument is generally sourced by reference to § 1.1275-4(b)(9)(iv). Under § 1.1275-4(b)(9)(iv), a holder's deductions or loss related to a contingent payment debt instrument that are treated as ordinary losses are treated as deductions that are definitely related to the class of gross income to which income from such debt instrument belongs. Treasury and the Service believe that the same rule should apply for sourcing of losses related to Class One instruments. Accordingly, a holder's ordinary losses resulting from negative adjustments with respect to a Class One instrument would be given the same source as the interest income from the instrument. Similarly, Treasury and the Service believe that deductions or losses related to a Class One instrument that the holder treats as capital losses should, consistent with the general principles of § 1.865-1T(b)(2), be sourced based on the residence of the holder.

(g) Netting.

Treasury and the Service recognize that there are different character and source rules which relate to market gain or loss and currency gain or loss on a Class One instrument and are studying the extent to which netting of such gains or losses should be permitted. For illustration purposes, in Example 2 below, the amounts related to currency gain or loss and market gain or loss are computed separately. Comments are requested regarding the extent to which netting should be permitted.

3. Examples.

The following examples are intended to illustrate the principles outlined above. In each example, assume that the instrument described is a debt instrument for federal income tax purposes. No inference is intended, however, as to whether the instrument is a debt instrument for federal income tax purposes.

Example 1.

On December 31, 1999, Z, a calendar year U.S. resident taxpayer whose functional currency is the U.S. dollar, purchases, at original issue, a zero-coupon debt instrument with a non-currency contingency for £1,000. The debt instrument was issued by a foreign corporation. The debt instrument would be subject to § 1.1275-4(b) if it were denominated in dollars. The debt instrument's comparable yield, determined in British pounds under §§ 1.988-2(b)(2) and 1.1275-4(b), is 10 percent, compounded annually, and the projected payment schedule, as constructed under the principles of § 1.1275-4(b), provides for a single payment of £1210 on December 31, 2001 (consisting of a noncontingent payment of £975 and a projected payment of £235).

The debt instrument is a capital asset in the hands of Z. The payment actually made on December 31, 2001, is £1300. The relevant pound/dollar spot rates over the term of the instrument are as follows:

Date	Spot rate (pounds to dollars)
Dec. 31, 1999	£1.00=$1.00
Dec. 31, 2000	£1.00=$1.10
Dec. 31, 2001	£1.00=$1.20

Accrual period	Average rate (pounds to dollars)
2000	£1.00=$1.05
2001	£1.00=$1.15

(i) Treatment in 2000. (A) Determination of accrued interest. Under the principles of section 988 and based on the comparable yield, Z accrues £100 of interest on the debt instrument for 2000 (issue price of £1,000 x 10 percent). Z translates the £100 at the average exchange rate for the year (1.05 x £100 = $105). Accordingly, Z has interest income in 2000 of $105, which is foreign source under section 862(a)(1).

(B) Adjustments to issue price and basis relating to accrued interest. The adjusted issue price of the debt instrument determined in pounds and Z's adjusted basis in dollars in the debt instrument are increased by the accrued interest. Thus, on January 1, 2001, the adjusted issue price of the debt instrument is £1100. For purposes of determining Z's dollar basis in the debt instrument, the $1000 basis is increased by the £100 translated at the rate at which interest was accrued for 2000. Accordingly, Z's adjusted basis in the instrument in dollars is $1105 as of January 1, 2001.

(ii) Treatment in 2001. (A) Determination of accrued interest. Based on the comparable yield, Z's accrued interest for 2001 is £110 (adjusted issue price of £1100 x 10 percent). For purposes of computing Z's interest inclusions in dollars, the £110 of accrued interest is translated at the average exchange rate for 2001 (1.15 x £110 = $126.50).

(B) Effect of net positive adjustment. The payment actually made on December 31, 2001, is £1300, rather than the projected £1210. Under the principles of § 1.1275-4(b)(6)(i), Z has a net positive adjustment of £90 on December 31, 2001, attributable to the difference between the amount of the actual payment and the amount of the projected payment. The £90 net positive adjustment is treated as interest income and translated into dollars at the spot rate on the date the payment is received (1.2 x £90 = $108). Accordingly, Z has a net positive adjustment of $108 resulting in a total interest inclusion for 2001 of $234.50 ($126.50 + $108).

(C) Adjustments to issue price and basis relating to accrued interest. Based on the projected payment schedule, the adjusted issue price of the debt instrument immediately before the payment at maturity is £1210 (£1100 plus £110 of accrued interest for 2001). Z's adjusted basis, in dollars, is $1231.50 ($1105 plus $126.50 of accrued interest for 2001).

(D) Amount realized.

(i) Even though Z receives £1300 at maturity, for purposes of determining the amount realized, Z is treated as receiving the projected amount of the contingent payment on December 31, 2001. Therefore, Z is treated as receiving £1210 on December 31, 2001.

(ii) For purposes of determining the amount realized (other than for purposes of determining foreign exchange gain or loss as calculated below) in dollars, £100 (representing the interest accrued in 2000) is translated into dollars at the rate at which it was accrued (£1 = $1.05), resulting in an amount realized of $105; £110 of the £1210 (representing the interest accrued in 2001) is translated into dollars at the rate at which such payment was accrued (£1 = $1.15), resulting in an amount realized of $126.50; and £1000 (representing a return of principal) is translated into dollars at the spot rate on the date the instrument was purchased (£1 = $1), resulting in an amount realized of $1000. Accordingly, Z's total amount realized is $1231.50, the same as its basis, and Z recognizes no gain or loss (prior to consideration of foreign exchange gain or loss) on the retirement of the instrument.

(E) Foreign exchange gain or loss. Z realizes foreign exchange gain under section 988 on the instrument as a result of the difference in the exchange rate at which interest was accrued on the instrument and the spot rate on the date the instrument matures. With respect to interest accrued in 2000, this foreign exchange gain equals £100 x ($1.2 - $1.05) = $15.00 (i.e., the amount of the interest payment multiplied by the difference between the exchange rate on the date the interest payment was received (£1=$1.2) and the exchange rate at which interest was accrued during 2001 (£1=$1.05)). With respect to interest accrued in 2001, this foreign exchange gain equals £110 x ($1.2 - $1.15) = $5.50. Z also has foreign exchange gain on the repayment of the principal of the debt instrument. Such foreign exchange gain equals £1000 x ($1.2 - $1.0) = $200 (i.e., the amount of principal received multiplied by the difference between the spot rate on the date the debt instrument matures and the spot rate on the date Z purchased the instrument). Thus, Z recognizes a total foreign exchange gain on December 31, 2001, of $220.50

(F) Source. In 2001, Z has interest income of $234.50 (attributable to £110 of accrued interest and the £90 net positive adjustment) which under section 862(a)(1) is sourced by reference to the residence of the payor and is therefore foreign source.
Z also has foreign exchange gain of $220.50, which under § 1.988-4 is sourced by reference to Z's residence and is therefore U.S. source.

Example 2.

Assume the same facts as in Example 1 except that at maturity Z receives £975 instead of £1300.

(i) Treatment in 2000. (A) Determination of accrued interest. Under the principles of section 988 and based on the comparable yield, Z accrues £100 of interest on the debt instrument for 2000 (issue price of £1,000 x 10 percent). Z translates the £100 at the average exchange rate for the year (1.05 x £100 = $105). Accordingly, Z has interest income in 2000 of $105, which is foreign source under section 862(a)(1).

(B) Adjustments to issue price and basis relating to accrued interest. The adjusted issue price of the debt instrument determined in pounds and Z's adjusted basis in dollars in the debt instrument are increased by the accrued interest. Thus, on January 1, 2001, the adjusted issue price of the debt instrument is £1100. For purposes of determining Z's dollar basis in the debt instrument, the $1000 basis is increased by the £100 translated at the rate at which interest was accrued for 2000. Accordingly, Z's adjusted basis in the instrument in dollars is $1105 as of January 1, 2001.

(ii) Treatment in 2001. (A) Determination of accrued interest. Based on the comparable yield, Z's total daily portions of accrued interest are £110 for 2001 (adjusted issue price of £1100 x 10 percent). Despite the effect of the net negative adjustment set forth in (ii)(B) below, for purposes of computing Z's adjusted basis and amount realized the £110 of accrued interest is translated into dollars at the average spot rate at which such interest was accrued (£1 = $1.15) to equal $126.50.

(B) Effect of net negative adjustment on accrued interest. Z has a net negative adjustment of £235 on December 31, 2001, attributable to the difference between the amount of the actual payment (£0) and the amount of the projected payment (£235). Applying the principles of § 1.1275-4, Z's accrued interest income of £110 in 2001 is reduced in pounds by the net negative adjustment to zero.

Further, because Z previously accrued interest of £100 in the year 2000, Z treats £100 of the remaining £125 net negative adjustment as an ordinary loss. This ordinary loss is attributable to interest accrued but not paid in the preceding year. Therefore, Z translates the loss into dollars at the average rate for such year (£1 = $1.05). Accordingly, Z has an ordinary loss of $105. (See paragraph (ii) (D) and (E) below for the treatment of the remaining £25 of net negative adjustment).

(C) Adjustments to issue price and basis relating to accrued interest. Based on the projected payment schedule, the adjusted issue price of the debt instrument immediately before the payment at maturity is £1210 (£1100 plus £110 of accrued interest for 2001). Z's adjusted basis in dollars is $1231.50 ($1105, representing Z's adjusted basis at the end of 2000 (calculated in (i)(B) above), plus $126.50 accrued interest for 2001).

(D) Determination of amount realized.

(i) In pounds. Even though Z receives only £975 at maturity, for purposes of determining the amount realized by Z on retirement of the debt instrument, Z is treated as receiving the projected amount of the contingent payment (in pounds) on December 31, 2001, reduced by the amount of Z's negative adjustment carryforward of £25. Therefore, Z is treated as receiving £1185 (£1210 - £25) on December 31, 2001.

(ii) In dollars. Z translates its amount realized into dollars and computes its gain or loss on the instrument (other than foreign exchange gain or loss) pursuant to the payment ordering rules of § 1.988-2(b)(7). Pursuant to these rules, of the £1185 amount realized, £100 represents interest accrued in 2000, £110 represents interest accrued in 2001, and £975 represents a return of principal.

Of the amount realized of £1185, £100 is translated based on the rate interest was accrued in 2000 (£1 = $1.05) to equal $105. Another £110 is translated based on the rate interest was accrued in 2001 (£1 = $1.15) to equal $126.50. The remaining £975 is translated into dollars at the spot rate on the date the instrument was purchased (£1 = $1) to equal $975.

Accordingly, Z's amount realized (without taking into account foreign exchange gain or loss) is $1206.50 ($105 +$126.50 + $975), and Z computes a capital loss of $25 on the retirement of the instrument ($1206.50 - $1231.50 = $25).

(E) Foreign exchange gain or loss. Z computes a foreign exchange gain on the repayment of principal as follows: £975 x (1.2 - 1.0) (i.e., the amount of the principal payment multiplied by the difference between the spot rate on the date of payment (£1=$1.2) and the spot rate on the date the instrument was purchased (£1=$1.0)). Accordingly, Z's foreign exchange gain is $195. This foreign exchange gain is characterized as ordinary income. (Because the interest accrued in 2000 and 2001, as well as £25 of principal, was not actually received, no foreign exchange gain or loss is realized with respect to such amounts.)

(F) Sourcing.

(i) Losses. On December 31, 2001, Z has an ordinary loss of $105 (attributable to £100 of Z's previous interest inclusions) and a capital loss of $25. Under the principles of § 1.1275-4(b)(9)(iv), the $105 ordinary loss is allocated to the foreign source passive income category under section 904(d) and the regulations thereunder. Under the principles of § 1.865-1T(b)(2), the $25 capital loss is sourced based on Z's residence and, accordingly, is U.S. source.

(ii) Foreign currency gain. Z's foreign currency gain of $195 is sourced under

section 988(a)(3) by reference to the residence of Z. Thus, Z's foreign currency gain is U.S. source.

(G) Netting. On December 31, 2001, Z has an ordinary loss of $105 (attributable to £100 of Z' s previous interest inclusions as computed in paragraph (B)), a capital loss of $25 (attributable to the net negative adjustment on the instrument as computed in paragraph (D)) and an overall foreign exchange gain on the instrument of $195 (as computed in paragraph (E)). Treasury and the IRS request comments concerning whether such amounts should be treated separately by taxpayers or whether netting of these gains and losses for purposes of character and source should be required. Regulations could provide, for example, that taxpayers must net capital losses (resulting from net negative adjustments) against foreign exchange gains to avoid a character mismatch between gains and losses from a single instrument. This approach is similar to the one adopted by § 1.988-2(b)(8) with respect to the disposition of debt instruments.

B. Class Two Instruments.

Class Two instruments consist of contingent payment debt instruments for which payments of principal or interest are denominated in, or determined by reference to, more than one currency and which have no non-currency contingencies. For example, this class would include both a debt instrument that pays a fixed euro interest rate and principal in British pounds and a debt instrument that pays a fixed dollar interest rate and principal in Japanese Yen.

Treasury and the Service are studying an approach under which the proper accounting for a Class Two instrument issued for money or publicly traded property would require a determination of the comparable yield in a single currency and accrual of interest at such yield under the principles of § 1.1275-4(b). Under this approach, the regulations would require that the comparable yield on the debt instrument be determined in the debt instrument's predominant currency. In general, Treasury and the Service expect that the debt instrument's predominant currency would be determined by comparing the functional currency value of the payments denominated in (or determined by reference to) each currency on the issue date, appropriately discounted to present value (in each relevant currency) and translated at the spot rate on such date. Accordingly, in the case of a debt instrument issued for euros that pays a fixed euro interest rate and principal in British pounds, the issuer would determine the predominant currency on the issue date and then apply the principles of § 1.1275-4(b) to determine the comparable yield and projected payment schedule in that currency. For this purpose, payments not denominated in (or determined by reference to) the predominant currency would be treated in the same manner as non-currency contingencies in a Class One instrument.

Where a significant portion of the payments (as determined on a present value basis as of the issue date) with respect to a Class Two instrument is made in the functional currency of the taxpayer, the Treasury and the Service are studying whether the

regulations should treat the functional currency as the instrument's predominant currency. In such case, the comparable yield and projected payment schedule would be determined by applying the principles of § 1.1275-4(b) in the functional currency of the taxpayer. Payments denominated in the nonfunctional currency would be treated in the same manner as non-currency contingencies under § 1.1275-4(b). As a result, no section 988 foreign exchange gain or loss would be recognized with respect to a Class Two instrument for which a significant portion of payments is denominated in, or determined by reference to, the taxpayer's functional currency.

C. Class Three Instruments.

Class Three instruments are debt instruments for which payments of principal or interest are denominated in, or determined by reference to, more than one currency and which also have one or more non-currency contingencies. Consistent with the treatment of Class One and Class Two debt instruments, Treasury and the Service are considering an approach that would require taxpayers to determine the comparable yield of a Class Three instrument issued for money or publicly traded property by applying the principles of § 1.1275-4(b) in a single currency (which would be determined under the same methodology used for determining the predominant currency of a Class Two instrument). The principles of § 1.1275-4(b) would then be applied with respect to all of the contingent payments on the Class Three instrument (i.e., contingent payments denominated in the predominant currency and all payments denominated in, or determined by reference to, any currency other than the predominant currency).

V. Debt Issued for Non-publicly Traded Property.

Section 1.1275-4(c) provides rules for the treatment of contingent payment debt instruments issued for non-publicly traded property. Treasury and the Service are considering an approach that would apply the principles of § 1.1275-4(c) in the relevant nonfunctional currency and would require the translation of the resulting interest and principal components into the taxpayer's functional currency under the principles of section 988 and the regulations thereunder.

VI. Anti-abuse Rules.

Treasury and the Service recognize that a contingent payment debt instrument can be unbundled. These unbundled components, together with the underlying contingent payment debt instrument may lead to timing, character and source distortions. Treasury and the Service request comments on how to draft a narrowly tailored rule that would provide taxpayers with flexibility and certainty with respect to nonfunctional currency contingent instruments while preventing abuse.

VII. Comments.

Treasury and Service request comments on the matters discussed in this announcement within 90 days from **[the date of issuance]**. Written comments may be submitted to the Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Attention: CC:DOM:CORP:R (Announcement 99-76) , Room 5226, Washington DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Announcement 99-76) , Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington DC.

For further information regarding this announcement, contact Howard Wiener of the Office of Associate Chief Counsel (International) at 202-874-4160 (not a toll-free call).

REVENUE RULING 90-79

1990-2 C.B. 187, 1990-38 I.R.B. 26.

Internal Revenue Service
Revenue Ruling

CURRENCY GAIN OR LOSS RECOGNITION; MORTGAGE GAIN OR LOSS; PERSONAL RESIDENCE

Published: September 17, 1990

Section 988. - Treatment of Certain Foreign Currency Transactions, 26 CFR 1.988- 1T(a): Certain definitions and special rules (temporary).

(Also Section 165; 1.165-1.)

Currency gain or loss recognition; mortgage gain or loss; personal residence. Gain or loss realized by a U.S. citizen from the sale of a personal residence may not be offset by loss or gain realized from the repayment of a nonfunctional currency denominated mortgage loan used to finance the purchase of the residence.

ISSUE

Can an individual U.S. citizen offset the gain (or loss) realized from the sale of a personal residence with a loss (or gain) realized from the repayment of a nonfunctional currency denominated mortgage loan used to finance the purchase of the residence?

FACTS

In 1986 A, an individual U.S. citizen, purchased property in country X that A used exclusively as a personal residence. The purchase price was 95,000y. A financed the purchase with a loan of 85,000y when $1 equalled 1y, and 10,000y cash payment. In 1989 A sold the personal residence for 142,500y, and used 85,000y of the sale proceeds to repay the outstanding principal balance of the mortgage. At the time of the sale and repayment $1 equaled .95y.

A's basis in the personal residence is $95,000 (95,000y at $1 equals 1y). The amount realized upon the sale of the residence is $150,000 (142,500y at $1 equals .95y); therefore, A realizes a gain of $55,000 ($150,000 - $95,000).

A's functional currency under section 985(b)(1) of the Internal Revenue

Code is the United States dollar (dollar). The y is a nonfunctional currency with respect to A. None of the expenses incurred by A in connection with the purchase, financing, or sale of the personal residence were deductible under section 162 (relating to trade or business expenses) or section 212(1) or (2) (relating to expenses for the production of income).

LAW AND ANALYSIS

Section 985(a) of the Code generally provides that all income tax determinations shall be made in a taxpayer's functional currency. An individual may have a qualified business unit (QBU) that has a non-dollar functional currency. See section 1.989(a)-1(b) of the Income Tax Regulations. However, an activity that does not generate expenses that are deductible under either section 162 or section 212(1) or (2) does not qualify as a QBU. See section 1.989(a)-1(c) of the regulations. Therefore, A must make all income tax determinations with respect to the purchase, financing, and sale of the personal residence in the dollar.

Section 988 of the Code provides rules for the treatment of 'section 988 transactions' including becoming an obligor under a mortgage. Section 988(c)(1)(B)(i). However, under section 988(e), the rules of section 988 apply to a transaction entered into by an individual only to the extent expenses allocable to the transaction meets the requirements of section 162 or section 212(1) or (2). Because there are no expenses properly allocable to the mortgage that meet the requirements of either section 162 or section 212(1) or (2), the rules of section 988 do not apply to A's becoming an obligor under the mortgage. Therefore, the law predating section 988 governs. See S. Rep. No. 99- 313, 99th Cong., 2d Sess. 468-69 (1986), 1986-3 C.B. (vol. 3) 468-69.

Under the law predating section 988, the borrowing and repayment of the mortgage loan is a separate transaction from the purchase and sale of the personal residence. See Helburn v. Commissioner, 214 F.2d 815, 818-19 (1st Cir. 1954); Church's English Shoes, Ltd., 24 T.C. 56, 59 (1955), aff'd per curiam 229 F.2d 957 (2nd Cir. 1956); Rev. Rul. 78-281, 1978-2 C.B. 204. The repayment of the mortgage by A constitutes a closed, and therefore, taxable transaction. See Church's English Shoes, supra; and Rev. Rul. 78-281.

Since the y increased in value against the dollar between the time A's liability was fixed (at the time of the borrowing) and the time A repaid the loan, the amount of dollars required to retire the debt exceeded the dollar value of the amount originally borrowed. Therefore, A realized a loss on the loan repayment. The amount of the loss is $4,474. (The dollar value of 85,000y borrowed: $85,000, less the dollar value of 85,000y used to repay the loan $89,474).

Section 165(a) of the Code provides generally that a deduction shall be allowed for losses sustained during a taxable year and not compensated for by insurance or otherwise. Section 165(c) limits the loss deduction for individuals to losses incurred in a trade or business, losses incurred in any transaction entered into for profit, and casualty losses. Thus, an individual is not allowed to deduct all realized losses. See Billman v. Commissioner, 73 T.C. 139 (1979), where the Tax Court denied an individual a loss resulting from the devaluation of a foreign currency.

A's loss was not incurred in an activity or as the result of an event described in section 165(c) of the Code. Therefore A may not deduct the $4,474 realized loss. Similarly, if A had realized a loss on the sale of the personal residence and a gain on the repayment of the mortgage, A could not deduct the loss.

HOLDING

An individual may not offset the gain (or loss) realized from the sale of a personal residence with a loss (or gain) realized on the repayment of a nonfunctional currency denominated mortgage loan used to finance the purchase of the residence.

DRAFTING INFORMATION

The principal author of this revenue ruling is Mary Gillmarten of the Office of Assistant Chief Counsel (International). For further information regarding this revenue ruling, contact Ms. Gillmarten on (202) 566-6284 (not a toll-free call).

Rev. Rul. 90-79, 1990-2 C.B. 187, 1990-38 I.R.B. 26.

Internal Revenue Bulletin: 2008-2

January 14, 2008

Rev. Rul. 2008-1

Table of Contents

Foreign currency exchange traded notes. This ruling holds that a foreign currency exchange traded note is debt for U.S. federal tax purposes, even when the initial investment and repayment are made in U.S. dollars and the investor may get back fewer U.S. dollars than it invested. A companion publication to this ruling, Notice 2008-2, will ask for comments on prepaid forward contracts and similar arrangements that are not treated as debt for U.S. federal tax purposes.

ISSUE

What is the characterization for U.S. federal tax purposes of an instrument (described further below) that is issued and redeemed for U.S. dollars, but that provides an economic return that is determined by reference to the euro and market interest rates in respect of the euro?

FACTS

Assume that on January 1, 2007, the spot rate of exchange of U.S. dollars for euros was $1 = €0.75. On January 1, 2007, Holder delivered $100 to Issuer in exchange for the Issuer's obligation (the "Instrument") to deliver to Holder, on January 1, 2010, the U.S. dollar equivalent of an amount of euros (the "U.S. Dollar Equivalent Amount"). The U.S. Dollar Equivalent Amount is determinable on January 1, 2010, and is the sum of the following amounts translated into U.S. dollars at the spot rate on January 1, 2010: (i) €75, and (ii) an amount of euros calculated by reference to a compound stated rate of return applied to €75 from January 1, 2007, until January 1, 2010. The compound stated rate of return is the excess of a rate based on euro interest rates over a rate labeled as a "fee" for the benefit of the Issuer. (The U.S. Dollar Equivalent Amount to be paid by Issuer to Holder on January 1, 2010, may also be determined by reference to a mathematical formula that generates the same substantive effect as the methodology described above.)

Holder and Issuer expect that Issuer will pay the U.S. Dollar Equivalent Amount on January 1, 2010. The legal remedies provided in the Instrument are not materially different than legal remedies associated with instruments that are debt for federal tax purposes.

The U.S. dollar is the functional currency of Holder.

There is a significant possibility that the U.S. Dollar Equivalent Amount payable by Issuer to Holder on January 1, 2010, may be significantly less than $100.

ANALYSIS

An instrument that requires payments to be made in a foreign currency (that is, nonfunctional currency) can be debt for U.S. federal income tax purposes. *See, e.g.*, section 988(c)(1)(B)(i) of the Internal Revenue Code. Thus, although nonfunctional currency is considered to be "property" for U.S. federal tax purposes (*see, e.g.* , *Philip Morris Inc. v. Commissioner*, 71 F.3d 1040 (2d Cir. 1995), *aff'g* 104 T.C. 61 (1995); *National-Standard Company v. Commissioner*, 749 F.2d 369 (6th Cir. 1984), *aff'g* 80 T.C. 551 (1983)), it is treated like money for purposes of determining the amount and timing of interest that accrues on debt. *See* §1.988-2(b)(2) of the Income Tax Regulations; S. Rep. No. 313, 99th Cong., 2d Sess., 1986-3 (Vol. 3) C.B. 461-463 (1986).Section 988 and regulations thereunder also provide that the acquisition of a debt instrument or becoming the obligor under a debt instrument is a section 988 transaction if the amount that a taxpayer is entitled to receive or is required to pay is determined by reference to the value of a nonfunctional currency. *See, e.g.*, section 988(c)(1); §§ 1.988-1(a)(1) (flush language), 1.988-2(b)(2)(i)(B)(2). These provisions indicate that a financial instrument all the payments of which are determined by reference to a single currency can be debt, notwithstanding the fact that (i) all actual payments due under the instrument are made in a different payment currency, and (ii) the amount of the different payment currency that the issuer pays at maturity may be less than the amount of the different payment currency that was initially advanced. Indeed, section 988 was adopted, in part, to negate suggestions "that U.S. tax consequences can be manipulated by arranging to repay a foreign-currency denominated loan in U.S. dollars equivalent in value at repayment to the foreign currency borrowed." S. Rep. No. 313, 99th Cong., 2d Sess., 1986-3 (Vol. 3) C.B. 451 (1986). *See also* H.R. Rep. No. 426, 99th Cong. 1st Sess. 1986-3 (Vol. 2) C.B. 466 (1985) and General Explanation of the Tax Reform Act of 1986, 100th Cong., 1st Sess., 1087 (1987).

The Instrument, in form, resembles a U.S. dollar denominated derivative contract in which the Holder prepays its obligations under the contract, and is entitled to receive a return based exclusively on the value of property at maturity. (*See* Notice 2008-2, 2008-2 I.R.B. , dated January 14, 2008, requesting comments with respect to these types of derivative contracts.) However, the U.S. Dollar Equivalent Amount that is payable at maturity by the Issuer under the terms of the Instrument is determined exclusively by reference to (i) the U.S. dollar value of the euros at issuance and at maturity, and (ii) market interest rates in respect of the euro. At inception (on January 1, 2007), the Holder delivers the U.S. dollar equivalent of €75, and at maturity (on January 1, 2010) the Issuer is required to pay the U.S. dollar equivalent of €75, plus the U.S. dollar value at maturity of a return based on euro interest rates. The fact that intervening currency fluctuations may cause the amount of U.S. dollars that Holder receives at maturity (on January 1, 2010) to be less than the amount of U.S. dollars that the Holder paid for the Instrument (on January 1, 2007) does not affect the characterization of the Instrument as debt, which is based on an analysis of payments with respect to the euro. The Issuer's translation of U.S. dollars into euros (on January 1, 2007) and euros into U.S. dollars (on January 1, 2010) is not relevant to the Instrument's characterization.

HOLDING

For U.S. federal tax purposes, the Instrument is euro-denominated indebtedness of Issuer. This result is not affected if the Instrument is (i) privately offered, (ii) publicly offered, or (iii) traded on an exchange.

DRAFTING INFORMATION

The principal authors of this revenue ruling are John W. Rogers III of the Office of the Associate Chief Counsel (Financial Institutions & Products) and Margaret Harris of the Office of Associate Chief Counsel (International). For further information regarding this revenue ruling, contact Mr. Rogers at (202) 622-3950 or Ms. Harris at 202-622-3870 (not toll-free calls).

[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 8860]

RIN 1545-AP78

Treatment of Income and Expense From Certain Hyperinflationary, Nonfunctional Currency Transactions and Certain Notional Principal Contracts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations regarding the treatment of income and deductions arising from certain foreign currency transactions denominated in hyperinflationary currencies and coordinates section 988 with the section 446 regulations pertaining to significant nonperiodic payments. These regulations are intended to prevent distortions in computing income and deductions of taxpayers who enter into certain transactions in hyperinflationary currencies, and nonfunctional currency, notional principal contracts with significant nonperiodic payments.

DATES: These regulations are effective February 14, 2000**.**

FOR FURTHER INFORMATION CONTACT: Roger M. Brown at (202) 622-3830 (not a toll-free number) of the Office of the Associate Chief Counsel (International) within the Office of the Chief Counsel, Room 4554, 1111 Constitution Avenue, NW., Washington, DC. 20224.

SUPPLEMENTARY INFORMATION:

Background

On March 17, 1992, proposed regulations were published in the **Federal Register** at 57 FR 9217 (INTL-15-91). The IRS received two written comments on the proposed regulations, which are discussed below. No public hearing was held and no requests to speak were received. Having considered the comments, the IRS and Treasury Department adopt the proposed regulations, as modified by this Treasury decision.

Explanation of Provisions

I. Hyperinflationary Instruments

A. Proposed Regulations

The proposed regulations under §1.988-2(b)(15) generally provided that currency gain or loss on debt instruments and demand deposits entered into or acquired when the currency in which the item was denominated was hyperinflationary must be realized annually under a mark-to-market methodology. For purposes of determining the character and source (or allocation) of such currency gain or loss, the gain or loss was generally treated as an increase in, or a reduction of, interest income or expense.

The proposed §1.988-2(b)(15) regulations excluded instruments described in section 988(a)(3)(C) (relating to non-dollar, related-party loans where the rate of interest is at least 10 percentage points higher than the Federal mid-term rate) from these rules. Proposed regulations §1.988-2(d)(5) and (e)(7) generally provided that currency gain or loss realized with respect to section 988 forward contracts, futures contracts, option contracts and similar items (such as currency swap contracts) entered into or acquired when the currency in which such an item is denominated was hyperinflationary was recognized annually under a mark-to-market methodology.

B. Discussion of Comments and Final Regulations

1. Comments and the Treasury and IRS's responses

One of the comments responding to the proposed regulations criticized the exclusion of loans described in section 988(a)(3)(C) from the rules of proposed regulation §1.988-2(b)(15). The comment noted that it was inappropriate to treat related-party loans differently from loans between unrelated parties in this context.

Proposed regulation §1.988-2(b)(15) excluded loans subject to section 988(a)(3)(C) from the mark-to-market rule of the proposed regulations because the loans were already subject to mark-to-market treatment under section 988(a)(3)(C), which was enacted to prevent manipulation of the section 904(a) foreign tax credit limitation through related party loans with artificially high interest rates. See H. Conf. Rep. No. 841, 99th Cong., 2d Sess. 668 (1986). However, due to interest income's U.S. source treatment under section 988(a)(3)(C)(ii), mark-to-market treatment under section 988(a)(3)(C), rather than §1.988-2(b)(15), would be, in most cases, more unfavorable to taxpayers.

Since the rules of proposed regulation §1.988-2(b)(15) were consistent with the approach of section 988(a)(3)(C) and prevented manipulation of the type Congress addressed in that section, the IRS and Treasury agree that transactions described in section 988(a)(3)(C) should not be excluded from the mark-to-market rule of the final regulations. The IRS and Treasury also have concluded that to the extent a debt instrument is subject to the rules of §1.988-2(b)(15), the application of section 988(a)(3)(C)'s resourcing rule is not necessary. The final regulations reflect these changes.

The other comment identified the need for coordinating the mark-to-market regime for

hyperinflationary instruments under proposed regulation §1.988-2(b)(15), and the mark-to-market election under proposed regulation §1.988-5(f) for all section 988 transactions. The final regulations do not include a rule coordinating these two mark-to-market regimes because the mark-to-market election for all section 988 transactions is still in proposed form. Accordingly, the IRS and Treasury have decided that consideration of the proper coordination is most appropriate when the regulations relating to the general mark-to-market election for all section 988 transactions are finalized.

2. Other changes to the final regulations

(a) Source and Character of Gain or Loss

The proposed regulations provided that any exchange gain or loss realized upon marking to market a debt instrument or a demand deposit under proposed regulation §1.988-2(b)(15)(i) was to be directly allocable to the interest income or interest expense from the debt instrument or deposit. Accordingly, the gain or loss reduced or increased the amount of interest income or interest expense paid or accrued during that year with respect to that instrument or deposit. Additionally, if realized exchange gain exceeded interest expense of an issuer, or realized exchange loss exceeded interest income of a holder or depositor, the character and source of such excess amount were to be determined under the general rules of §§1.988-3 and 1.988-4.

The assumption underlying this proposed treatment was that in hyperinflationary conditions, high nominal interest rates perform two functions: compensate lenders for currency loss attributable to the repayment of the principal with a devalued currency, and account for borrowers' currency gain on the repayment of the principal with a devalued currency. In instances, however, where hyperinflationary conditions are subsiding and a lender would actually

have currency gain on principal repayment (and the borrower would have currency loss on principal repayment), these assumptions are no longer appropriate. For example, if a lender has currency gain on the marking to market (for currency fluctuations only) of the principal of a debt instrument, high nominal interest rates would not be compensating the lender for the decline in the value of the principal as there would be a gain on the principal.

Accordingly, the final regulations retain the source and character rule of the proposed regulations (direct allocation of the exchange gain or loss against interest expense or income, respectively) when hyperinflationary conditions result in exchange loss to lenders or exchange gain to borrowers on the principal amount of a debt instrument or deposit. However, where a lender has exchange gain or a borrower has exchange loss on the debt instrument -- which may occur as hyperinflationary conditions subside -- the final regulations clarify that the exchange gain or loss is not allocated against interest expense or income. Rather, the exchange gain or loss is treated under the normal currency character and source rules of §§1.988-3 and 1.988-4. Thus, for example, if an issuer has both interest expense and currency loss, the currency loss is sourced and characterized under section 988 and does not affect the determination of interest expense.

(b) Synthetic, Non-hyperinflationary Currency Debt Instruments

The final regulations also make clear that when a debt instrument has interest and principal payments that are to be made by reference to a non-hyperinflationary currency or item (commonly known as interest and principal protection features), the instrument is not marked to market under the final section 988 regulations. This is because the instrument is, in substance, a synthetic non-hyperinflationary instrument and does not experience the distortions associated with a hyperinflationary instrument.

(c) Treatment of Hyperinflationary Contracts

Proposed regulation §1.988-2(d)(5) generally provided that currency gain or loss on derivative contracts described in §1.988-1(a)(2)(iii) and denominated in a currency that was hyperinflationary at the time the contract was entered into was to be realized annually under a mark-to-market methodology. This proposed regulation was issued prior to promulgation of the §1.446-4 regulations (published in the **Federal Register** on July 18, 1994) which requires that, to clearly reflect income, the timing of income, deduction, gain or loss on a hedge must match the timing of income, deduction, gain or loss on the item being hedged. The final regulations modify proposed regulation §1.988-2(d)(5) by providing that §1.446-4, to the extent applicable, will take precedence over proposed regulation §1.988-2(d)(5). This is because the IRS and Treasury believe that a clearer reflection of income is present where the income and deductions arising from an item hedged under §1.446-4 is matched with the income and deductions arising from the hedge. See §1.446-4(b).

(d) Demand and Time Deposits

The proposed regulations applied the mark-to-market rules to demand deposits denominated in a currency that was hyperinflationary at the time the deposit was entered into. Under the final regulations, the mark-to-market rules apply to demand and time deposits that provide for payments denominated in or by reference to a currency which is hyperinflationary at the time the taxpayer enters into or otherwise acquires the deposit, or whose interest rate reflects hyperinflationary conditions in a country. Similar clarifications have been made with respect to the definitions of hyperinflationary debt instruments and currency swap contracts.

3. Abusive transactions

The Treasury and the IRS are concerned about the use of hyperinflationary currencies in transactions motivated by tax considerations. Because the direction of exchange rates is relatively predictable in hyperinflation economies, some taxpayers have attempted to use such currencies in transactions lacking economic substance. See, e.g., Agro Science Co. v. Commissioner, T.C. Memo. 1989-687, aff'd, 927 F.2d 213 (5th Cir.), cert. denied, 502 U.S. 907 (1991). However, section 988 may be applied by the IRS in a manner that reflects the proper timing, source, and character of income, gain, loss, or expense arising from a transaction whose form is not in accordance with its economic substance. §§1.988-1(a)(11) and 1.988-2(f); Agro Science Co. v. Commissioner, supra. Accordingly, the rules contained in this Treasury decision will be applied within the framework of these general economic substance principles.

II. Significant Non-periodic Payments and Currency Swaps

The proposed regulations coordinated section 988 with the section 446 regulations pertaining to significant nonperiodic payments. The final regulations maintain this coordination and clarify that exchange gain or loss may be realized on the principal and interest components of a significant nonperiodic payment.

III. Proposed Change to Base Period in Notice of Proposed Rulemaking

Elsewhere in this issue of the **Federal Register**, the IRS and Treasury are publishing a notice of proposed rulemaking that proposes to change the period during which inflation rates are measured in the determination of whether a currency is hyperinflationary for purposes of section 988 (base period). The effect of this change to §1.988-1(f) (defining hyperinflationary currency for purposes of section 988) is to take into account current year, hyperinflationary conditions, rather than determining whether a currency is hyperinflationary based on the three years prior to

the current year. The proposed change relates only to section 988 and not to the dollar approximate separate transactions method of §1.985-3 (DASTM). However, other sections, such as §1.267(f)-1(e) (relating to application of the loss disallowance rule of section 267(a)(1) as applied to related party, nonfunctional currency loans), which make reference to the section 988 definition of hyperinflation will be affected.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of these regulations is Roger M. Brown of the Office of the Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department also participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of the Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 ***

Par. 2. Section 1.988-0 in the Table of Contents is amended by:

1. The entry for §1.988-2(b)(14)-(15) is removed.

2. An entry for §1.988-2(b)(14) is added.

3. An entry for §1.988-2(b)(15) is added.

4. The entry for §1.988-2(d)(5) is revised.

5. The entry for §1.988-2(e)(7) is revised.

The revisions and additions read as follows:

<u>§1.988-0 Taxation of gain or loss from a section 988 transaction; Table of Contents.</u>

* * * * *

<u>§1.988-2 Recognition and computation of exchange gain or loss</u>.
* * * * *
(b) ***
(14) [Reserved]
(15) Debt instruments and deposits denominated in hyperinflationary currencies.
* * * * *
(d) ***
(5) Hyperinflationary contracts.
(e) ***
(7) Special rules for currency swap contracts in hyperinflationary currencies.
* * * * *

Par. 3. Section 1.988-2 is amended by:

1. Adding paragraphs (b)(14) and (b)(15).

2. Adding paragraph (d)(5).

3. Adding paragraph (e)(3)(iv).

4. Adding paragraph (e)(7).

The additions read as follows:

§1.988-2 Recognition and computation of exchange gain or loss.

* * * * *

(b) ***

(14) [Reserved]

(15) Debt instruments and deposits denominated in hyperinflationary currencies-- (i) In general. If a taxpayer issues, acquires, or otherwise enters into or holds a hyperinflationary debt instrument (as defined in paragraph (b)(15)(vi)(A) of this section) or a hyperinflationary deposit (as defined in paragraph (b)(15)(vi)(B) of this section) on which interest is paid or accrued that is denominated in (or determined by reference to) a nonfunctional currency of the taxpayer, then the taxpayer shall realize exchange gain or loss with respect to such instrument or deposit for its taxable year determined by reference to the change in exchange rates between--

(A) The later of the first day of the taxable year, or the date the instrument was entered into (or an amount deposited); and

(B) The earlier of the last day of the taxable year, or the date the instrument (or deposit) is disposed of or otherwise terminated.

(ii) Only exchange gain or loss is realized. No gain or loss is realized under paragraph (b)(15)(i) by reason of factors other than movement in exchange rates, such as the creditworthiness of the debtor.

(iii) Special rule for synthetic, non-hyperinflationary currency debt instruments--(A) General rule. Paragraph (b)(15)(i) does not apply to a debt instrument that has interest and principal payments that are to be made by reference to a currency or item that does not reflect

hyperinflationary conditions in a country (within the meaning of §1.988-1(f)).

(B) Example. Paragraph (b)(15)(iii)(A) is illustrated by the following example:

Example. When the Turkish lira (TL) is a hyperinflationary currency, A, a U.S. corporation with the U.S. dollar as its functional currency, makes a 5 year, 100,000 TL-denominated loan to B, an unrelated corporation, at a 10% interest rate when 1,000 TL equals $1. Under the terms of the debt instrument, B must pay interest annually to A in amount of Turkish lira that is equal to $100. Also under the terms of the debt instrument, B must pay A upon maturity of the debt instrument an amount of Turkish lira that is equal to $1,000. Although the principal and interest are payable in a hyperinflationary currency, the debt instrument is a synthetic dollar debt instrument and is not subject to paragraph (b)(15)(i) of this section.

(iv) Source and character of gain or loss--(A) General rule for hyperinflationary conditions. The rules of this paragraph (b)(15)(iv)(A) shall apply to any taxpayer that is either an issuer of (or obligor under) a hyperinflationary debt instrument or deposit and has currency gain on such debt instrument or deposit, or a holder of a hyperinflationary debt instrument or deposit and has currency loss on such debt instrument or deposit. For purposes of subtitle A of the Internal Revenue Code, any exchange gain or loss realized under paragraph (b)(15)(i) of this section is directly allocable to the interest expense or interest income, respectively, from the debt instrument or deposit (computed under this paragraph (b)), and therefore reduces or increases the amount of interest income or interest expense paid or accrued during that year with respect to that instrument or deposit. With respect to a debt instrument or deposit during a taxable year, to the extent exchange gain realized under paragraph (b)(15)(i) of this section exceeds interest expense of an issuer, or exchange loss realized under paragraph (b)(15)(i) of this section exceeds interest income of a holder or depositor, the character and source of such excess amount shall be determined under §§1.988-3 and 1.988-4.

(B) Special rule for subsiding hyperinflationary conditions. If the taxpayer is an issuer of

(or obligor under) a hyperinflationary debt instrument or deposit and has currency loss, or if the taxpayer is a holder of a hyperinflationary debt instrument or deposit and has currency gain, then for purposes of subtitle A of the Internal Revenue Code, the character and source of the currency gain or loss is determined under §§1.988-3 and 1.988-4. Thus, if an issuer has both interest expense and currency loss, the currency loss is sourced and characterized under section 988, and does not affect the determination of interest expense.

(v) Adjustment to principal or basis. Any exchange gain or loss realized under paragraph (b)(15)(i) of this section is an adjustment to the functional currency principal amount of the issuer, functional currency basis of the holder, or the functional currency amount of the deposit. This adjusted amount or basis is used in making subsequent computations of exchange gain or loss, computing the basis of assets for purposes of allocating interest under §§1.861-9T through 1.861-12T, and 1.882-5, or making other determinations that may be relevant for computing taxable income or loss.

(vi) Definitions--(A) Hyperinflationary debt instrument. A hyperinflationary debt instrument is a debt instrument that provides for--

(1) Payments denominated in or determined by reference to a currency that is hyperinflationary (as defined in §1.988-1(f)) at the time the taxpayer enters into or otherwise acquires the debt instrument; or

(2) Payments denominated in or determined by reference to a currency that is hyperinflationary (as defined in §1.988-1(f)) during the taxable year, and the terms of the instrument provide for the adjustment of principal or interest payments in a manner that reflects hyperinflation. For example, a debt instrument providing for a variable interest rate based on local

conditions and generally responding to changes in the local consumer price index will reflect hyperinflation.

(B) Hyperinflationary deposit. A hyperinflationary deposit is a demand or time deposit or similar instrument issued by a bank or other financial institution that provides for--

(1) Payments denominated in or determined by reference to a currency that is hyperinflationary (as defined in §1.988-1(f)) at the time the taxpayer enters into or otherwise acquires the deposit; or

(2) Payments denominated in or determined by reference to a currency that is hyperinflationary (as defined in §1.988-1(f)) during the taxable year, and the terms of the deposit provide for the adjustment of the deposit amount or interest payments in a manner that reflects hyperinflation.

(vii) Interaction with other provisions--(A) Interest allocation rules. In determining the amount of interest expense, this paragraph (b)(15) applies before §§1.861-9T through 1.861-12T, and 1.882-5.

(B) DASTM. With respect to a qualified business unit that uses the United States dollar approximate separate transactions method of accounting described in §1.985-3, paragraph (b)(15)(i) of this section does not apply.

(C) Interaction with section 988(a)(3)(C). Section 988(a)(3)(C) does not apply to a debt instrument subject to the rules of paragraph (b)(15)(i) of this section.

(D) Hedging rules. To the extent §1.446-4 or 1.988-5 apply, the rules of paragraph (b)(15)(i) of this section will not apply. This paragraph (b)(15)(vii)(D) does not apply if the application of §1.988-5 results in hyperinflationary debt instrument or deposit described in

paragraph (b)(15)(vi)(A) or (B) of this section.

(viii) Effective date. This paragraph (b)(15) applies to transactions entered into after February 14, 2000.

* * * * *

(d) * * *

(5) Hyperinflationary contracts--(i) In general. If a taxpayer acquires or otherwise enters into a hyperinflationary contract (as defined in paragraph (d)(5)(ii) of this section) that has payments to be made or received that are denominated in (or determined by reference to) a nonfunctional currency of the taxpayer, then the taxpayer shall realize exchange gain or loss with respect to such contract for its taxable year determined by reference to the change in exchange rates between--

(A) The later of the first day of the taxable year, or the date the contract was acquired or entered into; and

(B) The earlier of the last day of the taxable year, or the date the contract is disposed of or otherwise terminated.

(ii) Definition of hyperinflationary contract. A hyperinflationary contract is a contract described in paragraph (d)(1) of this section that provides for payments denominated in or determined by reference to a currency that is hyperinflationary (as defined in §1.988-1(f)) at the time the taxpayer acquires or otherwise enters into the contract.

(iii) Interaction with other provisions--(A) DASTM. With respect to a qualified business unit that uses the United States dollar approximate separate transactions method of accounting

described in §1.985-3, this paragraph (d)(5) does not apply.

(B) Hedging rules. To the extent §1.446-4 or 1.988-5 apply, this paragraph (d)(5) does not apply.

(C) Adjustment for subsequent transactions. Proper adjustments must be made in the amount of any gain or loss subsequently realized for gain or loss taken into account by reason of this paragraph (d)(5).

(iv) Effective date. This paragraph (d) (5) is applicable to transactions acquired or otherwise entered into after February 14, 2000**.**

(e) ***

(3) ***

(iv) Coordination with §1.446-3(g)(4) regarding swaps with significant nonperiodic payments. The rules of §1.446-3(g)(4) apply to any currency swap with a significant nonperiodic payment. Section 1.446-3(g)(4) applies before this paragraph (e)(3). Thus, if §1.446-3(g)(4) applies, currency gain or loss may be realized on the loan. This paragraph (e)(3)(iv) applies to transactions entered into after February 14, 2000**.**

* * * * *

(7) Special rules for currency swap contracts in hyperinflationary currencies--(i) In general. If a taxpayer enters into a hyperinflationary currency swap (as defined in paragraph (e)(7)(iv) of this section), then the taxpayer realizes exchange gain or loss for its taxable year with respect to such instrument determined by reference to the change in exchange rates between --

(A) The later of the first day of the taxable year, or the date the instrument was entered

into (by the taxpayer); and

(B) The earlier of the last day of the taxable year, or the date the instrument is disposed of or otherwise terminated.

(ii) Adjustment to principal or basis. Proper adjustments are made in the amount of any gain or loss subsequently realized for gain or loss taken into account by reason of this paragraph (e)(7).

(iii) Interaction with DASTM. With respect to a qualified business unit that uses the United States dollar approximate separate transactions method of accounting described in §1.985-3, this paragraph (e)(7) does not apply.

(iv) Definition of hyperinflationary currency swap contract. A hyperinflationary currency swap contract is a currency swap contract that provides for--

(A) Payments denominated in or determined by reference to a currency that is hyperinflationary (as defined in §1.988-1(f)) at the time the taxpayer enters into or otherwise acquires the currency swap; or

(B) Payments that are adjusted to take into account the fact that the currency is hyperinflationary (as defined in §1.988-1(f)) during the current taxable year. A currency swap contract that provides for periodic payments determined by reference to a variable interest rate based on local conditions and generally responding to changes in the local consumer price index is an example of this latter type of currency swap contract.

(v) Special effective date for nonfunctional hyperinflationary currency swap contracts. Paragraph (e)(7) applies to transactions entered into after February 14, 2000.

Robert E. Wenzel

Deputy Commissioner of Internal Revenue

Approved: 12-13-99

Jonathan Talisman

Acting Assistant Secretary of the Treasury

DEPARTMENT OF THE TREASURY
Internal Revenue Service

26 CFR Part 1

TD 8914

RIN 1545-AX67

Definition of Hyperinflationary Currency for Purposes of Section 988

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations concerning when a currency will be considered hyperinflationary for purposes of section 988. These final regulations are intended to prevent distortions associated with the computation of income and expense arising from section 988 transactions denominated in hyperinflationary currencies.

DATES: The effective date of this regulation is February 14, 2000.

FOR FURTHER INFORMATION CONTACT: John W. Rogers III of the Office of Associate Chief Counsel (International) at (202) 622-3870.

SUPPLEMENTARY INFORMATION:

Background

This document contains final Income Tax Regulations (26 CFR part 1) under section 988 of the Internal Revenue Code (Code). On March 17, 1992, the IRS and Treasury published final regulations (57 FR 9172) relating to the taxation of section 988 transactions, including, inter alia, transactions denominated in hyperinflationary currencies. Also on March 17, 1992, proposed regulations were published (57 FR

9217) relating to the treatment of certain financial instruments denominated in hyperinflationary currencies. The proposed regulations did not separately define hyperinflationary currency. Rather, they simply made reference to the definition in the final regulations, §1.988-1(f).

TD 8860 (65 FR 2026) (January 13, 2000) finalized the proposed regulations relating to the treatment of financial instruments denominated in hyperinflationary currencies. Also in that issue of the **Federal Register** was a notice of proposed rulemaking regarding a proposed change in the period of years that are considered in determining whether a currency is hyperinflationary for purposes of section 988 (base period). The notice of proposed rulemaking also provided notice of a public hearing on the proposed regulations. No requests to speak were received, and the public hearing was canceled. This Treasury decision finalizes the proposed regulations relating to the change in base period, with certain minor changes.

Explanation of Provisions

As set out in the notice of proposed rulemaking, the term hyperinflationary currency, as defined in §1.988-1(f), utilizes the definition in §1.985-1(b)(2)(ii)(D). This definition was developed in the context of the Dollar Approximate Separate Transactions Method (DASTM) regulations, §1.985-3, and generally considers the cumulative effects of inflation over the base period in determining whether a currency is hyperinflationary. In §1.985-1(b)(2)(ii)(D), the base period consists of the thirty-six calendar month period immediately preceding the first day of the current calendar year. Use of this base period is generally appropriate in the context of DASTM because a

qualified business unit needs to know in advance if it is subject to §1.985-3 calculations.

However, failure to take the current year's inflation into account for purposes of computing foreign currency gain or loss under section 988 may lead to distortions in income and expense because inflation may rise dramatically in single year. Accordingly, the IRS and Treasury believe that for purposes of section 988, it is more appropriate to consider the cumulative inflation rate over the thirty-six month period ending on the last day of the taxpayer's (or the qualified business unit's) current taxable year. This change in the base period, however, applies only for the purposes of section 988 and not for the purpose of determining whether a taxpayer (or QBU) is subject to the provisions of §1.985-3.

Summary of Comments

One comment was received in connection with the proposed change in the measurement of the base period under section 988. This comment relates to the application of the rule to regulated investment companies (RICs). The commenter stated that sections 852(a) and 4982 effectively require a RIC to distribute essentially all of its income during the calendar year in which it is earned. Thus, the commenter concluded that RICs need to know before the end of their tax year whether a particular currency is hyperinflationary. The Treasury and IRS recognize that the revised definition of base period could present an administrative burden for RICs. Accordingly, the final regulation provides that RICs are not subject to the revised base period standard of these final regulations.

A similar exclusion from the revised base period standard has been made for REITs due to their similar distribution requirements. The regulation has also been amended to provide that the Service may by notice provide that the revised base period standard shall not apply to any section 988 transaction of an entity with distribution requirements similar to that of RICs and REITs.

In addition, the regulation was amended to provide that generally accepted accounting principles may not apply to alter the base period outlined in paragraph (f)(1)(ii)(A) of this section. This change is intended to clarify that the last sentence of §1.985-1(b)(2)(ii)(D) may not be used to alter the base period for purposes of section 988.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and therefore, a Regulatory Flexibility Analysis is not required.

Drafting Information

The principal author of these regulations is John W. Rogers III of the Office of the Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department also participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1 -- INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. In §1.988-1, paragraph (f) is revised to read as follows:

§1.988-1 Certain definitions and special rules

* * * * *

(f) Hyperinflationary currency--(1) Definition--(i) General rule. For purposes of section 988, a hyperinflationary currency means a currency described in §1.985-1(b)(2)(ii)(D). Unless otherwise provided, the currency in any example used in §§1.988-1 through 1.988-5 is not a hyperinflationary currency.

(ii) Special rules for determining base period. In determining whether a currency is hyperinflationary under §1.985-1(b)(2)(ii)(D) for purposes of this paragraph (f), the following rules will apply:

(A) The base period means the thirty-six calendar month period ending on the last day of the taxpayer's (or qualified business unit's) current taxable year. Thus, for example, if for 1996, 1997, and 1998, a country's annual inflation rates are 6 percent, 11 percent, and 90 percent, respectively, the cumulative inflation rate for the three-year

base period is 124% [((1.06 x 1.11 x 1.90) - 1.0 = 1.24) x 100 = 124%]. Accordingly, assuming the QBU has a calendar year as its taxable year, the currency of the country is hyperinflationary for the 1998 taxable year. This change in the §1.985-1(b)(2)(ii)(D) base period shall not apply to any section 988 transaction of an entity described in section 851 (regulated investment company (RIC)) or section 856 (real estate investment trust (REIT)). The Service may, by notice, provide that the foregoing change in the §1.985-1(b)(2)(ii)(D) base period does not apply to any section 988 transaction of an entity with distribution requirements similar to a RIC or REIT.

(B) The last sentence of §1.985-1(b)(2)(ii)(D) shall not apply to alter the base period for purposes of this paragraph (f) in determining whether a currency is hyperinflationary for purposes of section 988. Accordingly, generally accepted accounting principles may not apply to alter the base period for purposes of this paragraph (f).

(2) Effective date. Paragraph (f)(1) of this section shall apply to transactions entered into after February 14, 2000.

* * * * *

Robert E. Wenzel
Deputy Commissioner of Internal Revenue

Approved:
11/29/00

Jonathan Talisman
Acting Assistant Secretary of
the Treasury

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 9157]

RIN 1545-AW33

Guidance Regarding the Treatment of Certain Contingent Payment Debt Instruments with One or More Payments that Are Denominated in, or Determined by Reference to, a Nonfunctional Currency

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document contains final regulations regarding the treatment of contingent payment debt instruments for which one or more payments are denominated in, or determined by reference to, a currency other than the taxpayer's functional currency. These regulations are necessary because current regulations do not provide guidance concerning the tax treatment of such instruments. The regulations affect issuers and holders of such instruments.

DATES: Effective Date: These regulations are effective August 30, 2004.

Applicability date: These regulations apply to debt instruments issued on or after October 29, 2004.

FOR FURTHER INFORMATION CONTACT: Milton Cahn, (202) 622-3860 (not a toll free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1831. Responses to these collections of information are mandatory.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number assigned by the Office of Management and Budget.

The estimated annual burden per [respondent/recordkeeper] varies from 48 minutes to 1 hour 12 minutes, depending on individual circumstances, with an estimated average of 1 hour.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to this collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains amendments to 26 CFR part 1. On August 29, 2003, a notice of proposed rulemaking (REG-106486-98) relating to the taxation of nonfunctional currency denominated contingent payment debt instruments was published in the **Federal Register** (68 FR 51944). No public hearing was requested or held. One written comment responding to the notice of proposed rulemaking was received. After consideration of this comment, the proposed regulations are adopted as amended by this Treasury decision. The revisions are discussed below.

Summary of Comments

Treasury and the IRS received one comment letter in response to the notice of proposed rulemaking. The issues raised in that comment letter are addressed below.

1. <u>Exceptions Described in §1.1275-4(a)(2)</u>

The comment letter notes that in describing instruments subject to §1.988-6 by reference to §1.1275-4(b)(1), it was

unclear whether the exceptions set forth in §1.1275-4(a)(2) applied to instruments described in §1.988-6(a)(1).

It was intended to be implicit from the reference to §1.1275-4(b)(1) that debt instruments excluded from the application of §1.1275-4 by reason of §1.1275-4(a)(2) (other than by reason of being subject to section 988) are similarly excluded from §1.988-6. Nevertheless, the final regulations have been revised to make explicit that §1.988-6 applies only to debt instruments to which §1.1275-4 would otherwise apply (not taking into account the exclusion for debt instruments that are subject to section 988).

2. Multicurrency Debt Instruments With Related Hedges

The comment letter expresses concern that it may be possible to structure arrangements to avoid the original issue discount (OID) rules using a multicurrency debt instrument that has a nonfunctional currency as the predominant currency and partial hedges of that instrument. That is, it may be possible to closely replicate the economic attributes of a dollar denominated instrument with OID through a combination of a multicurrency instrument without OID and a partial hedge of that instrument. The comment letter suggests that §1.988-5(a) would not apply in such a case, because the hedge would not be a complete hedge of all payments.

Treasury and the IRS believe that an anti-abuse rule is appropriate to prevent the potential abuse described above. Accordingly, an anti-abuse rule applicable to debt instruments subject to section 988 is included in §1.988-2(b)(18). This anti-abuse rule is patterned after the anti-abuse rule contained in §1.1275-2(g) and permits the Commissioner to apply or depart from the applicable regulations as necessary or appropriate to achieve a reasonable result. No inference is intended as to how the Commissioner may apply the anti-abuse rule contained in §1.1275-2(g) to nonfunctional currency denominated debt instruments.

In addition, Treasury and the IRS believe that §1.988-2(f) may be applied in the situation described. Furthermore, Treasury and the IRS note that under §1.988-5(a)(8)(iii) the Commissioner can integrate a foreign currency denominated debt instrument with a partial hedge of that instrument.

3. Multicurrency Debt Instrument--Determination of Predominant Currency

The comment letter proposes the use of a special anti-abuse rule in the case where the net present value of all payments in, or determined with respect to, the predominant currency of a multicurrency instrument does not exceed 50 percent of the present value of all payments. The letter requests that, in such a case, the comparable yield be determined on a synthetic

basis by reference to the weighted average of the comparable yields in each component currency rather than by reference to the predominant currency. There are two stated rationales for this request. First, the holder could avoid accrual of OID if a multicurrency contingent payment debt instrument's predominant currency is a currency with a low interest rate and the other currencies in which payments are denominated or with respect to which payments are determined are highly inflationary currencies (but not hyperinflationary currencies). Second, if the predominant low interest rate currency in such an instrument is the U.S. dollar and the issuer is foreign, a holder's gain upon disposition of the instrument would be characterized as foreign source interest income rather than as U.S. source foreign currency gain.

Treasury and the IRS agree that the letter has identified an issue to be addressed. However, Treasury and the IRS believe the proposed solution of creating a synthetic yield (and presumably a synthetic currency to measure currency gain or loss) is overly complex and would be difficult to administer. Instead, Treasury and the IRS have added a special rule that applies if there is no single currency for which the net present value in functional currency of all payments denominated in, or determined by reference to, that currency is greater than 50

percent of the total value of all payments. In such a case, if the discount rate attributable to the currency that would otherwise be the predominant currency differs by 10 percentage points or more from the discount rate attributable to any other currency in which payments are denominated or with respect to which payments are determined, the Commissioner can determine the predominant currency under any reasonable method.

4. Integrated Debt Instruments

The comment letter requests clarification that §1.988-6 does not apply to transactions that are composed of a nonfunctional currency contingent payment debt instrument (or a multicurrency debt instrument) and a qualified hedge and that are subject to the integration rules of §1.988-5. Treasury and the IRS believe that the proposed regulations are clear on this point, because §1.988-5(a)(5)(i) provides that a taxpayer may treat a debt instrument and a hedge as an integrated economic transaction only if, among other things, all the contingent features of an instrument are fully hedged such that the synthetic debt instrument resulting from integration is not a contingent payment instrument. Accordingly, no change has been made in the final regulations regarding this issue.

5. Alternative Payment Schedule and Fixed Yield Rules

Section 1.1275-4(a)(2)(iii) provides that the contingent payment debt instrument rules in §1.1275-4 do not apply to a debt instrument subject to §1.1272-1(c) (a debt instrument that provides for certain alternative payment schedules) or §1.1272-1(d) (a debt instrument that provides for a fixed yield). The comment letter requests that the final regulations clarify that, for purposes of applying §§1.1272-1(c) and 1.1272-1(d) to a nonfunctional currency denominated debt instrument, the yield of the instrument be determined in the instrument's denomination currency, rather than in the taxpayer's functional currency. Treasury and the IRS believe that it is clear under §1.988-2(b)(2)(ii)(A) (determinations regarding OID in a nonfunctional currency denominated debt instrument are made in the currency of the debt instrument) that these provisions are applied by using the debt instrument's denomination currency. Accordingly, no change has been made in the final regulations regarding this issue.

6. Predominant Currency of a Multicurrency Debt Instrument is the Same as the Taxpayer's Functional Currency

The comment letter requests that the final regulations clarify that if the predominant currency of a multicurrency debt instrument is the taxpayer's functional currency, then section 988 does not apply to that instrument. Treasury and the IRS believe that §1.988-6(d)(4) of the proposed regulations is clear

on this point. Accordingly, no further clarification is made in the final regulations.

7. Other Regulatory Provisions

The comment letter requests that the final regulations clarify that debt instruments subject to §1.988-6 be treated for purposes of other regulations as if they were subject to §1.1275-4. Section 1.988-6 provides that the rules of §1.1275-4 apply to debt instruments subject to §1.988-6, except as otherwise provided in §1.988-6. Accordingly, a reference to a debt instrument subject to §1.1275-4 will also refer to a debt instrument subject to §1.988-6, unless otherwise provided in §1.988-6. Treasury and the IRS therefore believe that no further clarification is necessary.

8. Netting Currency Gain or Loss With Other Gain or Loss Upon a Disposition of the Instrument

In response to a request in the preamble to the proposed regulations for comments regarding netting, the comment letter proposes that foreign currency gain or loss be netted with other gain or loss on the disposition of a debt instrument. Treasury and the IRS are concerned about this type of netting in the context of foreign currency contingent payment debt instruments. Depending on the particular terms of such an instrument, a change in value due to a contingency may be recognized for tax purposes in a year prior to the recognition of foreign currency

gain or loss upon disposition of the instrument or may be recognized concurrently with the recognition of foreign currency gain or loss upon disposition. Treasury and the IRS therefore have concluded that netting is not appropriate in the context of foreign currency contingent payment debt instruments.

9. Tax Exempt Foreign Currency Contingent Payment Debt Instruments

In response to a request in the preamble to the proposed regulations for comments regarding tax exempt foreign currency contingent payment debt instruments, the comment letter requests certain modifications to §1.1275-4(d)(3) to take into account the policy considerations underlying §1.988-3(c). Treasury and the IRS appreciate these comments but believe the matter deserves more careful study before any regulations specifically addressing tax exempt foreign currency contingent payment debt instruments can be issued.

10. Multicurrency Debt Instruments With no Non-Currency Contingencies

In response to the request for comments contained in the preamble to the proposed regulations, the comment letter requests that all gain or loss on a sale of a multicurrency debt instrument that has no non-currency contingencies be characterized wholly as foreign currency gain or loss. Treasury and the IRS are concerned that such treatment would differ

inappropriately from the treatment of gain or loss in respect of a contingent payment debt instrument that has currency contingencies and non-currency contingencies. Accordingly, no change has been made in the final regulations regarding this issue.

Effect on Other Documents

The following publications are obsolete with regard to debt instruments issued on or after October 29, 2004:

Announcement 99-76, 1999-2 C.B. 223.

Special Analyses

It has been determined that this final regulation is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that few, if any, small entities issue or hold foreign currency denominated contingent payment debt instruments. Generally, it is expected that the only domestic holders of these instruments will likely be financial institutions, investment banking firms, investment funds, and other sophisticated investors, due to the foreign currency risk and other contingencies inherent in these instruments. Therefore, a Regulatory Flexibility Analysis under

the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to 26 U.S.C. 7805(f), the notice of proposed rulemaking preceding these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Milton Cahn of the Office of the Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.988-0 is amended as follows:

1. The introductory text is revised.

2. Entries are added for §§1.988-2(b)(18), 1.988-2(h) and 1.988-6.

The revision and additions read as follows:

§1.988-0 Taxation of gain or loss from a section 988 transaction; Table of contents

This section lists captioned paragraphs contained in §§1.988-1 through 1.988-6.

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§1.988-2 Recognition and computation of exchange gain or loss.

* * * * *
(b) * * *
(18) Interaction of section 988 and §1.1275-2(g).
* * * * *
(h) Timing of income and deductions from notional principal contracts.
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§1.988-6 Nonfunctional currency contingent payment debt instruments.

(a) In general.
(1) Scope.
(2) Exception for hyperinflationary currencies.
(b) Instruments described in paragraph (a)(1)(i) of this section.
(1) In general.
(2) Application of noncontingent bond method.
(3) Treatment and translation of amounts determined under noncontingent bond method.
(4) Determination of gain or loss not attributable to foreign currency.
(5) Determination of foreign currency gain or loss.
(6) Source of gain or loss.
(7) Basis different from adjusted issue price.
(8) Fixed but deferred contingent payments.
(c) Examples.
(d) Multicurrency debt instruments.

(1) In general.
(2) Determination of denomination currency.
(3) Issuer/holder consistency.
(4) Treatment of payments in currencies other than the denomination currency.
(e) Instruments issued for nonpublicly traded property.
(1) Applicability.
(2) Separation into components.
(3) Treatment of components consisting of one or more noncontingent payments in the same currency.
(4) Treatment of components consisting of contingent payments.
(5) Basis different from adjusted issue price.
(6) Treatment of holder on sale, exchange, or retirement.
(f) Rules for nonfunctional currency tax exempt obligations described in §1.1275-4(d).
(g) Effective date.

Par. 3. Section 1.988-2 is amended by:

1. Adding the text of paragraph (b)(2)(i)(B)(1).

2. Revising paragraph (b)(2)(i)(B)(2).

3. Adding the text of paragraph (b)(18).

The additions and revision read as follows:

'1.988-2 Recognition and computation of exchange gain or loss.

* * * * *

(b) * * *

(2) * * *

(i) * * *

(B) * * * (1) Operative rules. See '1.988-6 for rules applicable to contingent payment debt instruments for which one or more payments are denominated in, or determined by reference to, a nonfunctional currency.

(2) Certain instruments are not contingent payment debt instruments. For purposes of sections 163(e) and 1271 through 1275 and the regulations thereunder, a debt instrument does not provide for contingent payments merely because the instrument is denominated in, or all payments of which are determined with reference to, a single nonfunctional currency. See §1.988-6 for the treatment of nonfunctional currency contingent payment debt instruments.

* * * * *

(18) Interaction of section 988 and §1.1275-2(g)--(i) In general. If a principal purpose of structuring a debt instrument subject to section 988 and any related hedges is to achieve a result that is unreasonable in light of the purposes of section 163(e), section 988, sections 1271 through 1275, or any related section of the Internal Revenue Code, the Commissioner can apply or depart from the regulations under the applicable sections as necessary or appropriate to achieve a reasonable result. For example, if this paragraph (b)(18) applies to a multicurrency debt instrument and a hedge or hedges, the Commissioner can wholly or partially integrate transactions or treat portions of the debt instrument as separate instruments where appropriate. See also §1.1275-2(g).

(ii) Unreasonable result. Whether a result is unreasonable is determined based on all the facts and circumstances. In making this determination, a significant fact is whether the treatment of the debt instrument is expected to have a substantial effect on the issuer's or a holder's U.S. tax liability. Another significant fact is whether the result is obtainable without the application of §1.988-6 and any related provisions (e.g., if the debt instrument and the contingency were entered into separately). A result will not be considered unreasonable, however, in the absence of an expected substantial effect on the present value of a taxpayer's tax liability.

(iii) Effective date. This paragraph (b)(18) shall apply to debt instruments issued on or after October 29, 2004.

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Par. 4. Section 1.988-6 is added to read as follows:

'1.988-6 Nonfunctional currency contingent payment debt instruments.

(a) In general--(1) Scope. This section determines the accrual of interest and the amount, timing, source, and character of any gain or loss on nonfunctional currency contingent payment debt instruments described in this paragraph (a)(1) and to which §1.1275-4(a) would otherwise apply if the debt instrument were denominated in the taxpayer's functional

currency. Except as provided by the rules in this section, the rules in '1.1275-4 (relating to contingent payment debt instruments) apply to the following instruments--

(i) A debt instrument described in '1.1275-4(b)(1) for which all payments of principal and interest are denominated in, or determined by reference to, a single nonfunctional currency and which has one or more non-currency related contingencies;

(ii) A debt instrument described in '1.1275-4(b)(1) for which payments of principal or interest are denominated in, or determined by reference to, more than one currency and which has no non-currency related contingencies;

(iii) A debt instrument described in '1.1275-4(b)(1) for which payments of principal or interest are denominated in, or determined by reference to, more than one currency and which has one or more non-currency related contingencies; and

(iv) A debt instrument otherwise described in paragraph (a)(1)(i), (ii) or (iii) of this section, except that the debt instrument is described in '1.1275-4(c)(1) rather than '1.1275-4(b)(1) (e.g., the instrument is issued for non-publicly traded property).

(2) Exception for hyperinflationary currencies--(i) In general. Except as provided in paragraph (a)(2)(ii) of this section, this section shall not apply to an instrument described

in paragraph (a)(1) of this section if any payment made under such instrument is determined by reference to a hyperinflationary currency, as defined in '1.985-1(b)(2)(ii)(D). In such case, the amount, timing, source and character of interest, principal, foreign currency gain or loss, and gain or loss relating to a non-currency contingency shall be determined under the method that reflects the instrument=s economic substance.

(ii) Discretion as to method. If a taxpayer does not account for an instrument described in paragraph (a)(2)(i) of this section in a manner that reflects the instrument=s economic substance, the Commissioner may apply the rules of this section to such an instrument or apply the principles of '1.988-2(b)(15), reasonably taking into account the contingent feature or features of the instrument.

(b) Instruments described in paragraph (a)(1)(i) of this section--(1) In general. Paragraph (b)(2) of this section provides rules for applying the noncontingent bond method (as set forth in '1.1275-4(b)) in the nonfunctional currency in which a debt instrument described in paragraph (a)(1)(i) of this section is denominated, or by reference to which its payments are determined (the denomination currency). Paragraph (b)(3) of this section describes how amounts determined in paragraph

(b)(2) of this section shall be translated from the denomination currency of the instrument into the taxpayer=s functional currency. Paragraph (b)(4) of this section describes how gain or loss (other than foreign currency gain or loss) shall be determined and characterized with respect to the instrument. Paragraph (b)(5) of this section describes how foreign currency gain or loss shall be determined with respect to accrued interest and principal on the instrument. Paragraph (b)(6) of this section provides rules for determining the source and character of any gain or loss with respect to the instrument. Paragraph (b)(7) of this section provides rules for subsequent holders of an instrument who purchase the instrument for an amount other than the adjusted issue price of the instrument. Paragraph (c) of this section provides examples of the application of paragraph (b) of this section. See paragraph (d) of this section for the determination of the denomination currency of an instrument described in paragraph (a)(1)(ii) or (iii) of this section. See paragraph (e) of this section for the treatment of an instrument described in paragraph (a)(1)(iv) of this section.

(2) Application of noncontingent bond method--(i) Accrued interest. Interest accruals on an instrument described in paragraph (a)(1)(i) of this section are initially determined in

the denomination currency of the instrument by applying the noncontingent bond method, set forth in '1.1275-4(b), to the instrument in its denomination currency. Accordingly, the comparable yield, projected payment schedule, and comparable fixed rate debt instrument, described in '1.1275-4(b)(4), are determined in the denomination currency. For purposes of applying the noncontingent bond method to instruments described in this paragraph, the applicable Federal rate described in '1.1275-4(b)(4)(i) shall be the rate described in '1.1274-4(d) with respect to the denomination currency.

(ii) Net positive and negative adjustments. Positive and negative adjustments, and net positive and net negative adjustments, with respect to an instrument described in paragraph (a)(1)(i) of this section are determined by applying the rules of '1.1275-4(b)(6) (and '1.1275-4(b)(9)(i) and (ii), if applicable) in the denomination currency. Accordingly, a net positive adjustment is treated as additional interest (in the denomination currency) on the instrument. A net negative adjustment first reduces interest that otherwise would be accrued by the taxpayer during the current tax year in the denomination currency. If a net negative adjustment exceeds the interest that would otherwise be accrued by the taxpayer during the current tax year in the denomination currency, the excess is

treated as ordinary loss (if the taxpayer is a holder of the instrument) or ordinary income (if the taxpayer is the issuer of the instrument). The amount treated as ordinary loss by a holder with respect to a net negative adjustment is limited, however, to the amount by which the holder=s total interest inclusions on the debt instrument (determined in the denomination currency) exceed the total amount of the holder=s net negative adjustments treated as ordinary loss on the debt instrument in prior taxable years (determined in the denomination currency). Similarly, the amount treated as ordinary income by an issuer with respect to a net negative adjustment is limited to the amount by which the issuer=s total interest deductions on the debt instrument (determined in the denomination currency) exceed the total amount of the issuer=s net negative adjustments treated as ordinary income on the debt instrument in prior taxable years (determined in the denomination currency). To the extent a net negative adjustment exceeds the current year=s interest accrual and the amount treated as ordinary loss to a holder (or ordinary income to the issuer), the excess is treated as a negative adjustment carryforward, within the meaning of '1.1275-4(b)(6)(iii)(C), in the denomination currency.

(iii) Adjusted issue price. The adjusted issue price of an instrument described in paragraph (a)(1)(i) of this section is

determined by applying the rules of '1.1275-4(b)(7) in the denomination currency. Accordingly, the adjusted issue price is equal to the debt instrument=s issue price in the denomination currency, increased by the interest previously accrued on the debt instrument (determined without regard to any net positive or net negative adjustments on the instrument) and decreased by the amount of any noncontingent payment and the projected amount of any contingent payment previously made on the instrument. All adjustments to the adjusted issue price are calculated in the denomination currency.

(iv) Adjusted basis. The adjusted basis of an instrument described in paragraph (a)(1)(i) of this section is determined by applying the rules of '1.1275-4(b)(7) in the taxpayer=s functional currency. In accordance with those rules, a holder=s basis in the debt instrument is increased by the interest previously accrued on the debt instrument (translated into functional currency), without regard to any net positive or net negative adjustments on the instrument (except as provided in paragraph (b)(7) or (8) of this section, if applicable), and decreased by the amount of any noncontingent payment and the projected amount of any contingent payment previously made on the instrument to the holder (translated into functional

currency). See paragraph (b)(3)(iii) of this section for translation rules.

(v) Amount realized. The amount realized by a holder and the repurchase price paid by the issuer on the scheduled or unscheduled retirement of a debt instrument described in paragraph (a)(1)(i) of this section are determined by applying the rules of '1.1275-4(b)(7) in the denomination currency. For example, with regard to a scheduled retirement at maturity, the holder is treated as receiving the projected amount of any contingent payment due at maturity, reduced by the amount of any negative adjustment carryforward. For purposes of translating the amount realized by the holder into functional currency, the rules of paragraph (b)(3)(iv) of this section shall apply.

(3) Treatment and translation of amounts determined under noncontingent bond method--(i) Accrued interest. The amount of accrued interest, determined under paragraph (b)(2)(i) of this section, is translated into the taxpayer=s functional currency at the average exchange rate, as described in '1.988-2(b)(2)(iii)(A), or, at the taxpayer's election, at the appropriate spot rate, as described in '1.988-2(b)(2)(iii)(B).

(ii) Net positive and negative adjustments--(A) Net positive adjustments. A net positive adjustment, as referenced in paragraph (b)(2)(ii) of this section, is translated into the

taxpayer=s functional currency at the spot rate on the last day of the taxable year in which the adjustment is taken into account under '1.1275-4(b)(6), or, if earlier, the date the instrument is disposed of or otherwise terminated.

(B) Net negative adjustments. A net negative adjustment is treated and, where necessary, is translated from the denomination currency into the taxpayer=s functional currency under the following rules:

(1) The amount of a net negative adjustment determined in the denomination currency that reduces the current year=s interest in that currency shall first reduce the current year=s accrued but unpaid interest, and then shall reduce the current year=s interest which was accrued and paid. No translation is required.

(2) The amount of a net negative adjustment treated as ordinary income or loss under '1.1275-4(b)(6)(iii)(B) first is attributable to accrued but unpaid interest accrued in prior taxable years. For this purpose, the net negative adjustment shall be treated as attributable to any unpaid interest accrued in the immediately preceding taxable year, and thereafter to unpaid interest accrued in each preceding taxable year. The amount of the net negative adjustment applied to accrued but unpaid interest is translated into functional currency at the

same rate used, in each of the respective prior taxable years, to translate the accrued interest.

(3) Any amount of the net negative adjustment remaining after the application of paragraphs (b)(3)(ii)(B)(1) and (2) of this section is attributable to interest accrued and paid in prior taxable years. The amount of the net negative adjustment applied to such amounts is translated into functional currency at the spot rate on the date the debt instrument was issued or, if later, acquired.

(4) Any amount of the net negative adjustment remaining after application of paragraphs (b)(3)(ii)(B)(1), (2) and (3) of this section is a negative adjustment carryforward, within the meaning of '1.1275-4(b)(6)(iii)(C). A negative adjustment carryforward is carried forward in the denomination currency and is applied to reduce interest accruals in subsequent years. In the year in which the instrument is sold, exchanged or retired, any negative adjustment carryforward not applied to interest reduces the holder=s amount realized on the instrument (in the denomination currency). An issuer of a debt instrument described in paragraph (a)(1)(i) of this section who takes into income a negative adjustment carryforward (that is not applied to interest) in the year the instrument is retired, as described in

'1.1275-4(b)(6)(iii)(C), translates such income into functional currency at the spot rate on the date the instrument was issued.

(iii) Adjusted basis--(A) In general. Except as otherwise provided in this paragraph and paragraph (b)(7) or (8) of this section, a holder determines and maintains adjusted basis by translating the denomination currency amounts determined under '1.1275-4(b)(7)(iii) into functional currency as follows:

(1) The holder=s initial basis in the instrument is determined by translating the amount paid by the holder to acquire the instrument (in the denomination currency) into functional currency at the spot rate on the date the instrument was issued or, if later, acquired.

(2) An increase in basis attributable to interest accrued on the instrument is translated at the rate applicable to such interest under paragraph (b)(3)(i) of this section.

(3) Any noncontingent payment and the projected amount of any contingent payments determined in the denomination currency that decrease the holder=s basis in the instrument under '1.1275-4(b)(7)(iii) are translated as follows:

(i) The payment first is attributable to the most recently accrued interest to which prior amounts have not already been attributed. The payment is translated into functional currency at the rate at which the interest was accrued.

(ii) Any amount remaining after the application of paragraph (b)(3)(iii)(A)(3)(i) of this section is attributable to principal. Such amounts are translated into functional currency at the spot rate on the date the instrument was issued or, if later, acquired.

(B) Exception for interest reduced by a negative adjustment carryforward. Solely for purposes of this '1.988-6, any amounts of accrued interest income that are reduced as a result of a negative adjustment carryforward shall be treated as principal and translated at the spot rate on the date the instrument was issued or, if later, acquired.

(iv) Amount realized--(A) Instrument held to maturity--(1) In general. With respect to an instrument held to maturity, a holder translates the amount realized by separating such amount in the denomination currency into the component parts of interest and principal that make up adjusted basis prior to translation under paragraph (b)(3)(iii) of this section, and translating each of those component parts of the amount realized at the same rate used to translate the respective component parts of basis under paragraph (b)(3)(iii) of this section. The amount realized first shall be translated by reference to the component parts of basis consisting of accrued interest during the taxpayer=s holding period as determined under paragraph

(b)(3)(iii) of this section and ordering such amounts on a last in first out basis. Any remaining portion of the amount realized shall be translated by reference to the rate used to translate the component of basis consisting of principal as determined under paragraph (b)(3)(iii) of this section.

(2) Subsequent purchases at discount and fixed but deferred contingent payments. For purposes of this paragraph (b)(3)(iv) of this section, any amount which is required to be added to adjusted basis under paragraph (b)(7) or (8) of this section shall be treated as additional interest which was accrued on the date the amount was added to adjusted basis. To the extent included in amount realized, such amounts shall be translated into functional currency at the same rates at which they were translated for purposes of determining adjusted basis. See paragraphs (b)(7)(iv) and (b)(8) of this section for rules governing the rates at which the amounts are translated for purposes of determining adjusted basis.

(B) Sale, exchange, or unscheduled retirement--(1) Holder. In the case of a sale, exchange, or unscheduled retirement, application of the rule stated in paragraph (b)(3)(iv)(A) of this section shall be as follows. The holder=s amount realized first shall be translated by reference to the principal component of basis as determined under paragraph (b)(3)(iii) of

this section, and then to the component of basis consisting of accrued interest as determined under paragraph (b)(3)(iii) of this section and ordering such amounts on a first in first out basis. Any gain recognized by the holder (i.e., any excess of the sale price over the holder=s basis, both expressed in the denomination currency) is translated into functional currency at the spot rate on the payment date.

(2) Issuer. In the case of an unscheduled retirement of the debt instrument, any excess of the adjusted issue price of the debt instrument over the amount paid by the issuer (expressed in denomination currency) shall first be attributable to accrued unpaid interest, to the extent the accrued unpaid interest had not been previously offset by a negative adjustment, on a last-in-first-out basis, and then to principal. The accrued unpaid interest shall be translated into functional currency at the rate at which the interest was accrued. The principal shall be translated at the spot rate on the date the debt instrument was issued.

(C) Effect of negative adjustment carryforward with respect to the issuer. Any amount of negative adjustment carryforward treated as ordinary income under '1.1275-4(b)(6)(iii)(C) shall be translated at the exchange rate on the day the debt instrument was issued.

(4) Determination of gain or loss not attributable to foreign currency. A holder of a debt instrument described in paragraph (a)(1)(i) of this section shall recognize gain or loss upon sale, exchange, or retirement of the instrument equal to the difference between the amount realized with respect to the instrument, translated into functional currency as described in paragraph (b)(3)(iv) of this section, and the adjusted basis in the instrument, determined and maintained in functional currency as described in paragraph (b)(3)(iii) of this section. The amount of any gain or loss so determined is characterized as provided in '1.1275-4(b)(8), and sourced as provided in paragraph (b)(6) of this section.

(5) Determination of foreign currency gain or loss--(i) In general. Other than in a taxable disposition of the debt instrument, foreign currency gain or loss is recognized with respect to a debt instrument described in paragraph (a)(1)(i) of this section only when payments are made or received. No foreign currency gain or loss is recognized with respect to a net positive or negative adjustment, as determined under paragraph (b)(2)(ii) of this section (except with respect to a positive adjustment described in paragraph (b)(8) of this section). As described in this paragraph (b)(5), foreign currency gain or loss is determined in accordance with the rules of '1.988-2(b).

(ii) Foreign currency gain or loss attributable to accrued interest. The amount of foreign currency gain or loss recognized with respect to payments of interest previously accrued on the instrument is determined by translating the amount of interest paid or received into functional currency at the spot rate on the date of payment and subtracting from such amount the amount determined by translating the interest paid or received into functional currency at the rate at which such interest was accrued under the rules of paragraph (b)(3)(i) of this section. For purposes of this paragraph, the amount of any payment that is treated as accrued interest shall be reduced by the amount of any net negative adjustment treated as ordinary loss (to the holder) or ordinary income (to the issuer), as provided in paragraph (b)(2)(ii) of this section. For purposes of determining whether the payment consists of interest or principal, see the payment ordering rules in paragraph (b)(5)(iv) of this section.

(iii) Principal. The amount of foreign currency gain or loss recognized with respect to payment or receipt of principal is determined by translating the amount paid or received into functional currency at the spot rate on the date of payment or receipt and subtracting from such amount the amount determined by translating the principal into functional currency at the spot rate on the date the instrument was issued or, in case of the

holder, if later, acquired. For purposes of determining whether the payment consists of interest or principal, see the payment ordering rules in paragraph (b)(5)(iv) of this section.

(iv) Payment ordering rules--(A) In general. Except as provided in paragraph (b)(5)(iv)(B) of this section, payments with respect to an instrument described in paragraph (a)(1)(i) of this section shall be treated as follows:

(1) A payment shall first be attributable to any net positive adjustment on the instrument that has not previously been taken into account.

(2) Any amount remaining after applying paragraph (b)(5)(iv)(A)(1) of this section shall be attributable to accrued but unpaid interest, remaining after reduction by any net negative adjustment, and shall be attributable to the most recent accrual period to the extent prior amounts have not already been attributed to such period.

(3) Any amount remaining after applying paragraphs (b)(5)(iv)(A)(1) and (2) of this section shall be attributable to principal. Any interest paid in the current year that is reduced by a net negative adjustment shall be considered a payment of principal for purposes of determining foreign currency gain or loss.

(B) Special rule for sale or exchange or unscheduled retirement. Payments made or received upon a sale or exchange or unscheduled retirement shall first be applied against the principal of the debt instrument (or in the case of a subsequent purchaser, the purchase price of the instrument in denomination currency) and then against accrued unpaid interest (in the case of a holder, accrued while the holder held the instrument).

(C) Subsequent purchaser that has a positive adjustment allocated to a daily portion of interest. A positive adjustment that is allocated to a daily portion of interest pursuant to paragraph (b)(7)(iv) of this section shall be treated as interest for purposes of applying the payment ordering rule of this paragraph (b)(5)(iv).

(6) Source of gain or loss. The source of foreign currency gain or loss recognized with respect to an instrument described in paragraph (a)(1)(i) of this section shall be determined pursuant to '1.988-4. Consistent with the rules of '1.1275-4(b)(8), all gain (other than foreign currency gain) on an instrument described in paragraph (a)(1)(i) of this section is treated as interest income for all purposes. The source of an ordinary loss (other than foreign currency loss) with respect to an instrument described in paragraph (a)(1)(i) of this section shall be determined pursuant to '1.1275-4(b)(9)(iv). The source

of a capital loss with respect to an instrument described in paragraph (a)(1)(i) of this section shall be determined pursuant to '1.865-1(b)(2).

(7) Basis different from adjusted issue price--(i) In general. The rules of '1.1275-4(b)(9)(i), except as set forth in this paragraph (b)(7), shall apply to an instrument described in paragraph (a)(1)(i) of this section purchased by a subsequent holder for more or less than the instrument=s adjusted issue price.

(ii) Determination of basis. If an instrument described in paragraph (a)(1)(i) of this section is purchased by a subsequent holder, the subsequent holder=s initial basis in the instrument shall equal the amount paid by the holder to acquire the instrument, translated into functional currency at the spot rate on the date of acquisition.

(iii) Purchase price greater than adjusted issue price. If the purchase price of the instrument (determined in the denomination currency) exceeds the adjusted issue price of the instrument, the holder shall, consistent with the rules of '1.1275-4(b)(9)(i)(B), reasonably allocate such excess to the daily portions of interest accrued on the instrument or to a projected payment on the instrument. To the extent attributable to interest, the excess shall be reasonably allocated over the remaining term of the

instrument to the daily portions of interest accrued and shall be a negative adjustment on the dates the daily portions accrue. On the date of such adjustment, the holder=s adjusted basis in the instrument is reduced by the amount treated as a negative adjustment under this paragraph (b)(7)(iii), translated into functional currency at the rate used to translate the interest which is offset by the negative adjustment. To the extent related to a projected payment, such excess shall be treated as a negative adjustment on the date the payment is made. On the date of such adjustment, the holder=s adjusted basis in the instrument is reduced by the amount treated as a negative adjustment under this paragraph (b)(7)(iii), translated into functional currency at the spot rate on the date the instrument was acquired.

(iv) Purchase price less than adjusted issue price. If the purchase price of the instrument (determined in the denomination currency) is less than the adjusted issue price of the instrument, the holder shall, consistent with the rules of '1.1275-4(b)(9)(i)(C), reasonably allocate the difference to the daily portions of interest accrued on the instrument or to a projected payment on the instrument. To the extent attributable to interest, the difference shall be reasonably allocated over the remaining term of the instrument to the daily portions of interest accrued and shall be a positive adjustment on the dates

the daily portions accrue. On the date of such adjustment, the holder=s adjusted basis in the instrument is increased by the amount treated as a positive adjustment under this paragraph (b)(7)(iv), translated into functional currency at the rate used to translate the interest to which it relates. For purposes of determining adjusted basis under paragraph (b)(3)(iii) of this section, such increase in adjusted basis shall be treated as an additional accrual of interest during the period to which the positive adjustment relates. To the extent related to a projected payment, such difference shall be treated as a positive adjustment on the date the payment is made. On the date of such adjustment, the holder=s adjusted basis in the instrument is increased by the amount treated as a positive adjustment under this paragraph (b)(7)(iv), translated into functional currency at the spot rate on the date the adjustment is taken into account. For purposes of determining the amount realized on the instrument in functional currency under paragraph (b)(3)(iv) of this section, amounts attributable to the excess of the adjusted issue price of the instrument over the purchase price of the instrument shall be translated into functional currency at the same rate at which the corresponding adjustments are taken into account under this paragraph (b)(7)(iv) for purposes of determining the adjusted basis of the instrument.

(8) Fixed but deferred contingent payments. In the case of an instrument with a contingent payment that becomes fixed as to amount before the payment is due, the rules of '1.1275-4(b)(9)(ii) shall be applied in the denomination currency of the instrument. For this purpose, foreign currency gain or loss shall be recognized on the date payment is made or received with respect to the instrument under the principles of paragraph (b)(5) of this section. Any increase or decrease in basis required under '1.1275-4(b)(9)(ii)(D) shall be taken into account at the same exchange rate as the corresponding net positive or negative adjustment is taken into account.

(c) Examples. The provisions of paragraph (b) of this section may be illustrated by the following examples. In each example, assume that the instrument described is a debt instrument for federal income tax purposes. No inference is intended, however, as to whether the instrument is a debt instrument for federal income tax purposes. The examples are as follows:

Example 1. Treatment of net positive adjustment--(i) Facts. On December 31, 2004, Z, a calendar year U.S. resident taxpayer whose functional currency is the U.S. dollar, purchases from a foreign corporation, at original issue, a zero-coupon debt instrument with a non-currency contingency for ,1000. All payments of principal and interest with respect to the instrument are denominated in, or determined by reference to, a single nonfunctional currency (the British pound). The debt instrument would be subject to '1.1275-4(b) if it were denominated in dollars. The debt instrument's comparable yield, determined in British pounds under paragraph (b)(2)(i) of this section and '1.1275-4(b), is 10 percent, compounded annually, and the

projected payment schedule, as constructed under the rules of '1.1275-4(b), provides for a single payment of ,1210 on December 31, 2006 (consisting of a noncontingent payment of ,975 and a projected payment of ,235). The debt instrument is a capital asset in the hands of Z. Z does not elect to use the spot-rate convention described in '1.988-2(b)(2)(iii)(B). The payment actually made on December 31, 2006, is ,1300. The relevant pound/dollar spot rates over the term of the instrument are as follows:

Date	Spot rate (pounds to dollars)
Dec. 31, 2004	,1.00=$ 1.00
Dec. 31, 2005	,1.00=$ 1.10
Dec. 31, 2006	,1.00=$ 1.20

Accrual period	Average rate (pounds to dollars)
2005	,1.00=$ 1.05
2006	,1.00=$ 1.15

(ii) Treatment in 2005--(A) Determination of accrued interest. Under paragraph (b)(2)(i) of this section, and based on the comparable yield, Z accrues ,100 of interest on the debt instrument for 2005 (issue price of ,1000 x 10 percent). Under paragraph (b)(3)(i) of this section, Z translates the ,100 at the average exchange rate for the accrual period ($1.05 x ,100 = $105). Accordingly, Z has interest income in 2005 of $105.

(B) Adjusted issue price and basis. Under paragraphs (b)(2)(iii) and (iv) of this section, the adjusted issue price of the debt instrument determined in pounds and Z's adjusted basis in dollars in the debt instrument are increased by the interest accrued in 2005. Thus, on January 1, 2006, the adjusted issue price of the debt instrument is ,1100. For purposes of determining Z's dollar basis in the debt instrument, the $1000 basis ($1.00 x ,1000 original cost basis) is increased by the ,100 of accrued interest, translated at the rate at which interest was accrued for 2005. See paragraph (b)(3)(iii) of this

section. Accordingly, Z's adjusted basis in the debt instrument as of January 1, 2006, is $1105.

(iii) Treatment in 2006--(A) Determination of accrued interest. Under paragraph (b)(2)(i) of this section, and based on the comparable yield, Z accrues ,110 of interest on the debt instrument for 2006 (adjusted issue price of ,1100 x 10 percent). Under paragraph (b)(3)(i) of this section, Z translates the ,110 at the average exchange rate for the accrual period ($1.15 x ,110 = $126.50). Accordingly, Z has interest income in 2006 of $126.50.

(B) Effect of net positive adjustment. The payment actually made on December 31, 2006, is ,1300, rather than the projected ,1210. Under paragraph (b)(2)(ii) of this section, Z has a net positive adjustment of ,90 on December 31, 2006, attributable to the difference between the amount of the actual payment and the amount of the projected payment. Under paragraph (b)(3)(ii)(A) of this section, the ,90 net positive adjustment is treated as additional interest income and is translated into dollars at the spot rate on the last day of the year ($1.20 x ,90 = $108). Accordingly, Z has a net positive adjustment of $108 resulting in a total interest inclusion for 2006 of $234.50 ($126.50 + $108 = $234.50).

(C) Adjusted issue price and basis. Based on the projected payment schedule, the adjusted issue price of the debt instrument immediately before the payment at maturity is ,1210 (,1100 plus ,110 of accrued interest for 2006). Z's adjusted basis in dollars, based only on the noncontingent payment and the projected amount of the contingent payment to be received, is $1231.50 ($1105 plus $126.50 of accrued interest for 2006).

(D) Amount realized. Even though Z receives ,1300 at maturity, for purposes of determining the amount realized, Z is treated under paragraph (b)(2)(v) of this section as receiving the projected amount of the contingent payment on December 31, 2006. Therefore, Z is treated as receiving ,1210 on December 31, 2006. Under paragraph (b)(3)(iv) of this section, Z translates its amount realized into dollars and computes its gain or loss on the instrument (other than foreign currency gain or loss) by breaking the amount realized into its component parts. Accordingly, ,100 of the ,1210 (representing the interest accrued in 2005) is translated at the rate at which it was accrued (,1 = $1.05), resulting in an amount realized of $105; ,110 of the ,1210 (representing the interest accrued in 2006) is translated

into dollars at the rate at which it was accrued (,1 = $1.15), resulting in an amount realized of $126.50; and ,1000 of the ,1210 (representing a return of principal) is translated into dollars at the spot rate on the date the instrument was purchased (,1 = $1), resulting in an amount realized of $1000. Z's total amount realized is $1231.50, the same as its basis, and Z recognizes no gain or loss (before consideration of foreign currency gain or loss) on retirement of the instrument.

(E) Foreign currency gain or loss. Under paragraph (b)(5) of this section Z recognizes foreign currency gain under section 988 on the instrument with respect to the consideration actually received at maturity (except for the net positive adjustment), ,1210. The amount of recognized foreign currency gain is determined based on the difference between the spot rate on the date the instrument matures and the rates at which the principal and interest were taken into account. With respect to the portion of the payment attributable to interest accrued in 2005, the foreign currency gain is $15 [,100 x ($1.20 - $1.05)]. With respect to interest accrued in 2006, the foreign currency gain equals $5.50 [,110 x ($1.20 - $1.15)]. With respect to principal, the foreign currency gain is $200 [,1000 x ($1.20 - $1.00)]. Thus, Z recognizes a total foreign currency gain on December 31, 2006, of $220.50.

(F) Source. Z has interest income of $105 in 2005, interest income of $234.50 in 2006 (attributable to ,110 of accrued interest and the ,90 net positive adjustment), and a foreign currency gain of $220.50 in 2006. Under paragraph (b)(6) of this section and section 862(a)(1), the interest income is sourced by reference to the residence of the payor and is therefore from sources without the United States. Under paragraph (b)(6) of this section and '1.988-4, Z=s foreign currency gain of $220.50 is sourced by reference to Z's residence and is therefore from sources within the United States.

Example 2. Treatment of net negative adjustment--(i) Facts. Assume the same facts as in Example 1, except that Z receives ,975 at maturity instead of ,1300.

(ii) Treatment in 2005. The treatment of the debt instrument in 2005 is the same as in Example 1. Thus, Z has interest income in 2005 of $105. On January 1, 2006, the adjusted issue price of the debt instrument is ,1100, and Z's adjusted basis in the instrument is $1105.

(iii) Treatment in 2006--(A) Determination of accrued interest. Under paragraph (b)(2)(i) of this section and based on the comparable yield, Z's accrued interest for 2006 is ,110 (adjusted issue price of ,1100 x 10 percent). Under paragraph (b)(3)(i) of this section, the ,110 of accrued interest is translated at the average exchange rate for the accrual period ($1.15 x ,110 = $126.50).

(B) Effect of net negative adjustment. The payment actually made on December 31, 2006, is ,975, rather than the projected ,1210. Under paragraph (b)(2)(ii) of this section, Z has a net negative adjustment of ,235 on December 31, 2006, attributable to the difference between the amount of the actual payment and the amount of the projected payment. Z's accrued interest income of ,110 in 2006 is reduced to zero by the net negative adjustment. Under paragraph (b)(3)(ii)(B)(1) of this section the net negative adjustment which reduces the current year=s interest is not translated into functional currency. Under paragraph (b)(2)(ii) of this section, Z treats the remaining ,125 net negative adjustment as an ordinary loss to the extent of the ,100 previously accrued interest in 2005. This ,100 ordinary loss is attributable to interest accrued but not paid in the preceding year. Therefore, under paragraph (b)(3)(ii)(B)(2) of this section, Z translates the loss into dollars at the average rate for such year (,1 = $1.05). Accordingly, Z has an ordinary loss of $105 in 2006. The remaining ,25 of net negative adjustment is a negative adjustment carryforward under paragraph (b)(2)(ii) of this section.

(C) Adjusted issue price and basis. Based on the projected payment schedule, the adjusted issue price of the debt instrument immediately before the payment at maturity is ,1210 (,1100 plus ,110 of accrued interest for 2006). Z's adjusted basis in dollars, based only on the noncontingent payments and the projected amount of the contingent payments to be received, is $1231.50 ($1105 plus $126.50 of accrued interest for 2006).

(D) Amount realized. Even though Z receives ,975 at maturity, for purposes of determining the amount realized, Z is treated under paragraph (b)(2)(v) of this section as receiving the projected amount of the contingent payment on December 31, 2006, reduced by the amount of Z's negative adjustment carryforward of ,25. Therefore, Z is treated as receiving ,1185 (,1210 - ,25) on December 31, 2006. Under paragraph (b)(3)(iv) of this section, Z translates its amount realized into dollars and computes its gain or loss on the instrument (other than foreign currency gain or

loss) by breaking the amount realized into its component parts. Accordingly, ,100 of the ,1185 (representing the interest accrued in 2005) is translated at the rate at which it was accrued (,1 = $1.05), resulting in an amount realized of $105; ,110 of the ,1185 (representing the interest accrued in 2006) is translated into dollars at the rate at which it was accrued (,1 = $1.15), resulting in an amount realized of $126.50; and ,975 of the ,1185 (representing a return of principal) is translated into dollars at the spot rate on the date the instrument was purchased (,1 = $1), resulting in an amount realized of $975. Z's amount realized is $1206.50 ($105 +$126.50 + $975 = $1206.50), and Z recognizes a capital loss (before consideration of foreign currency gain or loss) of $25 on retirement of the instrument ($1206.50 - $1231.50 = -$25).

(E) Foreign currency gain or loss. Z recognizes foreign currency gain with respect to the consideration actually received at maturity, ,975. Under paragraph (b)(5)(ii) of this section, no foreign currency gain or loss is recognized with respect to unpaid accrued interest reduced to zero by the net negative adjustment resulting in 2006. In addition, no foreign currency gain or loss is recognized with respect to unpaid accrued interest from 2005, also reduced to zero by the ordinary loss. Accordingly, Z recognizes foreign currency gain with respect to principal only. Thus, Z recognizes a total foreign currency gain on December 31, 2006, of $195 [,975 x ($1.20 - $1.00)].

(F) Source. In 2006, Z has an ordinary loss of $105, a capital loss of $25, and a foreign currency gain of $195. Under paragraph (b)(6) of this section and '1.1275-4(b)(9)(iv), the $105 ordinary loss generally reduces Z=s foreign source passive income under section 904(d) and the regulations thereunder. Under paragraph (b)(6) of this section and '1.865-1(b)(2), the $25 capital loss is sourced by reference to how interest income on the instrument would have been sourced. Therefore, the $25 capital loss generally reduces Z=s foreign source passive income under section 904(d) and the regulations thereunder. Under paragraph (b)(6) of this section and '1.988-4, Z=s foreign currency gain of $195 is sourced by reference to Z's residence and is therefore from sources within the United States.

Example 3. Negative adjustment and periodic interest payments --(i) Facts. On December 31, 2004, Z, a calendar year U.S. resident taxpayer whose functional currency is the U.S. dollar, purchases from a foreign corporation, at original issue, a two-year debt instrument with a non-currency contingency for ,1000.

All payments of principal and interest with respect to the instrument are denominated in, or determined by reference to, a single nonfunctional currency (the British pound). The debt instrument would be subject to '1.1275-4(b) if it were denominated in dollars. The debt instrument's comparable yield, determined in British pounds under ''1.988-2(b)(2) and 1.1275-4(b), is 10 percent, compounded semiannually. The debt instrument provides for semiannual interest payments of ,30 payable each June 30, and December 31, and a contingent payment at maturity on December 31, 2006, which is projected to equal ,1086.20 (consisting of a noncontingent payment of ,980 and a projected payment of ,106.20) in addition to the interest payable at maturity. The debt instrument is a capital asset in the hands of Z. Z does not elect to use the spot-rate convention described in '1.988-2(b)(2)(iii)(B). The payment actually made on December 31, 2006, is ,981.00. The relevant pound/dollar spot rates over the term of the instrument are as follows:

Date	Spot rate (pounds to dollars)
Dec. 31, 2004	,1.00=$ 1.00
June 30, 2005	,1.00=$ 1.20
Dec. 31, 2005	,1.00=$ 1.40
June 30, 2006	,1.00=$ 1.60
Dec. 31, 2006	,1.00=$ 1.80

Accrual period	Average rate (pounds to dollars)
Jan. - June 2005	,1.00=$ 1.10
July - Dec. 2005	,1.00=$ 1.30
Jan. - June 2006	,1.00=$ 1.50
July - Dec. 2006	,1.00=$ 1.70

(ii) Treatment in 2005--(A) Determination of accrued interest. Under paragraph (b)(2)(i) of this section, and based on the comparable yield, Z accrues ,50 of interest on the debt instrument for the January-June accrual period (issue price of ,1000 x 10 percent/2). Under paragraph (b)(3)(i) of this section, Z translates the ,50 at the average exchange rate for the accrual period ($1.10 x ,50 = $55.00). Similarly, Z accrues ,51 of interest in the July-December accrual period [(,1000 + ,50 - ,30)

x 10 percent/2], which is translated at the average exchange rate for the accrual period ($1.30 x ,51 = $66.30). Accordingly, Z accrues $121.30 of interest income in 2005.

(B) Adjusted issue price and basis--(1) January-June accrual period. Under paragraphs (b)(2)(iii) and (iv) of this section, the adjusted issue price of the debt instrument determined in pounds and Z's adjusted basis in dollars in the debt instrument are increased by the interest accrued, and decreased by the interest payment made, in the January-June accrual period. Thus, on July 1, 2005, the adjusted issue price of the debt instrument is ,1020 (,1000 + ,50 - ,30 = ,1020). For purposes of determining Z's dollar basis in the debt instrument, the $1000 basis is increased by the ,50 of accrued interest, translated, under paragraph (b)(3)(iii) of this section, at the rate at which interest was accrued for the January-June accrual period ($1.10 x ,50 = $55). The resulting amount is reduced by the ,30 payment of interest made during the accrual period, translated, under paragraph (b)(3)(iii) of this section and '1.988-2(b)(7), at the rate applicable to accrued interest ($1.10 x ,30 = $33). Accordingly, Z's adjusted basis as of July 1, 2005, is $1022 ($1000 + $55 - $33).

(2) July-December accrual period. Under paragraphs (b)(2)(iii) and (iv) of this section, the adjusted issue price of the debt instrument determined in pounds and Z's adjusted basis in dollars in the debt instrument are increased by the interest accrued, and decreased by the interest payment made, in the July-December accrual period. Thus, on January 1, 2006, the adjusted issue price of the instrument is ,1041 (,1020 + ,51 - ,30 = ,1041). For purposes of determining Z's dollar basis in the debt instrument, the $1022 basis is increased by the ,51 of accrued interest, translated, under paragraph (b)(3)(iii) of this section, at the rate at which interest was accrued for the July-December accrual period ($1.30 x ,51 = $66.30). The resulting amount is reduced by the ,30 payment of interest made during the accrual period, translated, under paragraph (b)(3)(iii) of this section and '1.988-2(b)(7), at the rate applicable to accrued interest ($1.30 x ,30 = $39). Accordingly, Z's adjusted basis as of January 1, 2006, is $1049.30 ($1022 + $66.30 - $39).

(C) Foreign currency gain or loss. Z will recognize foreign currency gain on the receipt of each ,30 payment of interest actually received during 2005. The amount of foreign currency gain in each case is determined, under paragraph (b)(5)(ii) of this section, by reference to the difference between the spot

rate on the date the ,30 payment was made and the average exchange rate for the accrual period during which the interest accrued. Accordingly, Z recognizes $3 of foreign currency gain on the January-June interest payment [,30 x ($1.20 - $1.10)], and $3 of foreign currency gain on the July-December interest payment [,30 x ($1.40 - $1.30)]. Z recognizes in 2005 a total of $6 of foreign currency gain.

(D) Source. Z has interest income of $121.30 and a foreign currency gain of $6. Under paragraph (b)(6) of this section and section 862(a)(1), the interest income is sourced by reference to the residence of the payor and is therefore from sources without the United States. Under paragraph (b)(6) of this section and '1.988-4, Z=s foreign currency gain of $6 is sourced by reference to Z's residence and is therefore from sources within the United States.

(iii) Treatment in 2006--(A) Determination of accrued interest. Under paragraph (b)(2)(i) of this section, and based on the comparable yield, Z's accrued interest for the January-June accrual period is ,52.05 (adjusted issue price of ,1041 x 10 percent/2). Under paragraph (b)(3)(i) of this section, Z translates the ,52.05 at the average exchange rate for the accrual period ($1.50 x ,52.05 = $78.08). Similarly, Z accrues ,53.15 of interest in the July-December accrual period [(,1041 + ,52.05 - ,30) x 10 percent/2], which is translated at the average exchange rate for the accrual period ($1.70 x ,53.15 = $90.35). Accordingly, Z accrues ,105.20, or $168.43, of interest income in 2006.

(B) Effect of net negative adjustment. The payment actually made on December 31, 2006, is ,981.00, rather than the projected ,1086.20. Under paragraph (b)(2)(ii)(B) of this section, Z has a net negative adjustment of ,105.20 on December 31, 2006, attributable to the difference between the amount of the actual payment and the amount of the projected payment. Z's accrued interest income of ,105.20 in 2006 is reduced to zero by the net negative adjustment. Elimination of the 2006 accrued interest fully utilizes the net negative adjustment.

(C) Adjusted issue price and basis--(1) January-June accrual period. Under paragraphs (b)(2)(iii) and (iv) of this section, the adjusted issue price of the debt instrument determined in pounds and Z's adjusted basis in dollars in the debt instrument are increased by the interest accrued, and decreased by the interest payment made, in the January-June accrual period. Thus,

on July 1, 2006, the adjusted issue price of the debt instrument is ,1063.05 (,1041 + ,52.05 - ,30 = ,1063.05). For purposes of determining Z's dollar basis in the debt instrument, the $1049.30 adjusted basis is increased by the ,52.05 of accrued interest, translated, under paragraph (b)(3)(iii) of this section, at the rate at which interest was accrued for the January-June accrual period ($1.50 x ,52.05 = $78.08). The resulting amount is reduced by the ,30 payment of interest made during the accrual period, translated, under paragraph (b)(3)(iii) of this section and '1.988-2(b)(7), at the rate applicable to accrued interest ($1.50 x ,30 = $45). Accordingly, Z's adjusted basis as of July 1, 2006, is $1082.38 ($1049.30 + $78.08 - $45).

(2) July-December accrual period. Under paragraphs (b)(2)(iii) and (iv) of this section, the adjusted issue price of the debt instrument determined in pounds and Z's adjusted basis in dollars in the debt instrument are increased by the interest accrued, and decreased by the interest payment made, in the July-December accrual period. Thus, immediately before maturity on December 31, 2006, the adjusted issue price of the instrument is ,1086.20 (,1063.05 + ,53.15 - ,30 = ,1086.20). For purposes of determining Z's dollar basis in the debt instrument, the $1082.38 adjusted basis is increased by the ,53.15 of accrued interest, translated, under paragraph (b)(3)(iii) of this section, at the rate at which interest was accrued for the July-December accrual period ($1.70 x ,53.15 = $90.36). The resulting amount is reduced by the ,30 payment of interest made during the accrual period, translated, under paragraph (b)(3)(iii) of this section and '1.988-2(b)(7), at the rate applicable to accrued interest ($1.70 x ,30 = $51). Accordingly, Z's adjusted basis on December 31, 2006, immediately prior to maturity is $1121.74 ($1082.38 + $90.36 - $51).

(D) Amount realized. Even though Z receives ,981.00 at maturity, for purposes of determining the amount realized, Z is treated under paragraph (b)(2)(v) of this section as receiving the projected amount of the contingent payment on December 31, 2006. Therefore, Z is treated as receiving ,1086.20 on December 31, 2006. Under paragraph (b)(3)(iv) of this section, Z translates its amount realized into dollars and computes its gain or loss on the instrument (other than foreign currency gain or loss) by breaking the amount realized into its component parts. Accordingly, ,20 of the ,1086.20 (representing the interest accrued in the January-June 2005 accrual period, less ,30 interest paid) is translated into dollars at the rate at which it was accrued (,1 = $1.10), resulting in an amount realized of $22; ,21 of the ,1086.20 (representing the interest accrued in the

July-December 2005 accrual period, less ,30 interest paid) is translated into dollars at the rate at which it was accrued (,1 = $1.30), resulting in an amount realized of $27.30; ,22.05 of the ,1086.20 (representing the interest accrued in the January-June 2006 accrual period, less ,30 interest paid) is translated into dollars at the rate at which it was accrued (,1 = $1.50), resulting in an amount realized of $33.08; ,23.15 of the ,1086.20 (representing the interest accrued in the July 1-December 31, 2006 accrual period, less the ,30 interest payment) is translated into dollars at the rate at which it was accrued (,1 = $1.70), resulting in an amount realized of $39.36; and ,1000 (representing principal) is translated into dollars at the spot rate on the date the instrument was purchased (,1 = $1), resulting in an amount realized of $1000. Accordingly, Z's total amount realized is $1121.74 ($22 + $27.30 + $33.08 + $39.36 + $1000), the same as its basis, and Z recognizes no gain or loss (before consideration of foreign currency gain or loss) on retirement of the instrument.

(E) Foreign currency gain or loss. Z recognizes foreign currency gain with respect to each ,30 payment actually received during 2006. These payments, however, are treated as payments of principal for this purpose because all 2006 accrued interest is reduced to zero by the net negative adjustment. See paragraph (b)(5)(iv)(A)(3) of this section. The amount of foreign currency gain in each case is determined, under paragraph (b)(5)(iii) of this section, by reference to the difference between the spot rate on the date the ,30 payment is made and the spot rate on the date the debt instrument was issued. Accordingly, Z recognizes $18 of foreign currency gain on the January-June 2006 interest payment [,30 x ($1.60 - $1.00)], and $24 of foreign currency gain on the July-December 2006 interest payment [,30 x ($1.80 - $1.00)]. Z separately recognizes foreign currency gain with respect to the consideration actually received at maturity, ,981.00. The amount of such gain is determined based on the difference between the spot rate on the date the instrument matures and the rates at which the principal and interest were taken into account. With respect to the portion of the payment attributable to interest accrued in January-June 2005 (other than the ,30 payments), the foreign currency gain is $14 [,20 x ($1.80 - $1.10)]. With respect to the portion of the payment attributable to interest accrued in July-December 2005 (other than the ,30 payments), the foreign currency gain is $10.50 [,21 x ($1.80 - $1.30)]. With respect to the portion of the payment attributable to interest accrued in 2006 (other than the ,30 payments), no foreign currency gain or loss is recognized under

paragraph (b)(5)(ii) of this section because such interest was reduced to zero by the net negative adjustment. With respect to the portion of the payment attributable to principal, the foreign currency gain is $752 [,940 x ($1.80 - $1.00)]. Thus, Z recognizes a foreign currency gain of $42 on receipt of the two ,30 payments in 2006, and $776.50 ($14 + $10.50 + $752) on receipt of the payment at maturity, for a total 2006 foreign currency gain of $818.50.

(F) Source. Under paragraph (b)(6) of this section and '1.988-4, Z=s foreign currency gain of $818.50 is sourced by reference to Z's residence and is therefore from sources within the United States.

Example 4. Purchase price greater than adjusted issue priceB-(i) Facts. On July 1, 2005, Z, a calendar year U.S. resident taxpayer whose functional currency is the U.S. dollar, purchases a debt instrument with a non-currency contingency for ,1405. All payments of principal and interest with respect to the instrument are denominated in, or determined by reference to, a single nonfunctional currency (the British pound). The debt instrument would be subject to '1.1275-4(b) if it were denominated in dollars. The debt instrument was originally issued by a foreign corporation on December 31, 2003, for an issue price of ,1000, and matures on December 31, 2006. The debt instrument's comparable yield, determined in British pounds under ''1.988-2(b)(2) and 1.1275-4(b), is 10.25 percent, compounded semiannually, and the projected payment schedule for the debt instrument (determined as of the issue date under the rules of '1.1275-4(b)) provides for a single payment at maturity of ,1349.70 (consisting of a noncontingent payment of ,1000 and a projected payment of ,349.70). At the time of the purchase, the adjusted issue price of the debt instrument is ,1161.76, assuming semiannual accrual periods ending on June 30 and December 31 of each year. The increase in the value of the debt instrument over its adjusted issue price is due to an increase in the expected amount of the contingent payment. The debt instrument is a capital asset in the hands of Z. Z does not elect to use the spot-rate convention described in '1.988-2(b)(2)(iii)(B). The payment actually made on December 31, 2006, is ,1400. The relevant pound/dollar spot rates over the term of the instrument are as follows:

Date	Spot rate (pounds to dollars)

July 1, 2005	,1.00=$ 1.00
Dec. 31, 2006	,1.00=$ 2.00

Accrual period	Average rate (pounds to dollars)
July 1 - December 31, 2005	,1.00=$ 1.50
January 1 - June 30, 2006	,1.00=$ 1.50
July 1 - December 31, 2006	,1.00=$ 1.50

(ii) Initial basis. Under paragraph (b)(7)(ii) of this section, Z=s initial basis in the debt instrument is $1405, Z=s purchase price of ,1405, translated into functional currency at the spot rate on the date the debt instrument was purchased (,1 = $1).

(iii) Allocation of purchase price differential. Z purchased the debt instrument for ,1405 when its adjusted issue price was ,1161.76. Under paragraph (b)(7)(iii) of this section, Z allocates the ,243.24 excess of purchase price over adjusted issue price to the contingent payment at maturity. This allocation is reasonable because the excess is due to an increase in the expected amount of the contingent payment and not, for example, to a decrease in prevailing interest rates.

(iv) Treatment in 2005--(A) Determination of accrued interest. Under paragraph (b)(2)(i) of this section, and based on the comparable yield, Z accrues ,59.54 of interest on the debt instrument for the July-December 2005 accrual period (issue price of ,1161.76 x 10.25 percent/2). Under paragraph (b)(3)(i) of this section, Z translates the ,59.54 of interest at the average exchange rate for the accrual period ($1.50 x ,59.54 = $89.31). Accordingly, Z has interest income in 2005 of $89.31.

(B) Adjusted issue price and basis. Under paragraphs (b)(2)(iii) and (iv) of this section, the adjusted issue price of the debt instrument determined in pounds and Z's adjusted basis in dollars in the debt instrument are increased by the interest accrued in July-December 2005. Thus, on January 1, 2006, the adjusted issue price of the debt instrument is ,1221.30 (,1161.76 + ,59.54). For purposes of determining Z's dollar basis in the debt instrument on January 1, 2006, the $1405 basis is increased by the ,59.54 of accrued interest, translated at the rate at which interest was accrued for the July-December 2005 accrual period. Paragraph (b)(3)(iii) of this section. Accordingly, Z's

adjusted basis in the instrument, as of January 1, 2006, is $1494.31 [$1405 + (,59.54 x $1.50)].

(v) Treatment in 2006--(A) Determination of accrued interest. Under paragraph (b)(2)(i) of this section, and based on the comparable yield, Z accrues ,62.59 of interest on the debt instrument for the January-June 2006 accrual period (issue price of ,1221.30 x 10.25 percent/2). Under paragraph (b)(3)(i) of this section, Z translates the ,62.59 of accrued interest at the average exchange rate for the accrual period ($1.50 x ,62.59 = $93.89). Similarly, Z accrues ,65.80 of interest in the July-December 2006 accrual period [(,1221.30 + ,62.59) x 10.25 percent/2], which is translated at the average exchange rate for the accrual period ($1.50 x ,65.80 = $98.70). Accordingly, Z accrues ,128.39, or $192.59, of interest income in 2006.

(B) Effect of positive and negative adjustments--(1) Offset of positive adjustment. The payment actually made on December 31, 2006, is ,1400, rather than the projected ,1349.70. Under paragraph (b)(2)(ii) of this section, Z has a positive adjustment of ,50.30 on December 31, 2006, attributable to the difference between the amount of the actual payment and the amount of the projected payment. Under paragraph (b)(7)(iii) of this section, however, Z also has a negative adjustment of ,243.24, attributable to the excess of Z=s purchase price for the debt instrument over its adjusted issue price. Accordingly, Z will have a net negative adjustment of ,192.94 (,50.30 - ,243.24 = -,192.94) for 2006.

(2) Offset of accrued interest. Z's accrued interest income of ,128.39 in 2006 is reduced to zero by the net negative adjustment. The net negative adjustment which reduces the current year=s interest is not translated into functional currency. Under paragraph (b)(2)(ii) of this section, Z treats the remaining ,64.55 net negative adjustment as an ordinary loss to the extent of the ,59.54 previously accrued interest in 2005. This ,59.54 ordinary loss is attributable to interest accrued but not paid in the preceding year. Therefore, under paragraph (b)(3)(ii)(B)(2) of this section, Z translates the loss into dollars at the average rate for such year (,1 = $1.50). Accordingly, Z has an ordinary loss of $89.31 in 2006. The remaining ,5.01 of net negative adjustment is a negative adjustment carryforward under paragraph (b)(2)(ii) of this section.

(C) Adjusted issue price and basis--(1) January-June accrual period. Under paragraph (b)(2)(iii) of this section, the adjusted

issue price of the debt instrument on July 1, 2006, is ,1283.89 (,1221.30 + ,62.59 = ,1283.89). Under paragraphs (b)(2)(iv) and (b)(3)(iii) of this section, Z's adjusted basis as of July 1, 2006, is $1588.20 ($1494.31 + $93.89).

(2) July-December accrual period. Based on the projected payment schedule, the adjusted issue price of the debt instrument immediately before the payment at maturity is ,1349.70 (,1283.89 + ,65.80 accrued interest for July-December). Z's adjusted basis in dollars, based only on the noncontingent payments and the projected amount of the contingent payments to be received, is $1686.90 ($1588.20 plus $98.70 of accrued interest for July-December).

(3) Adjustment to basis upon contingent payment. Under paragraph (b)(7)(iii) of this section, Z=s adjusted basis in the debt instrument is reduced at maturity by ,243.24, the excess of Z=s purchase price for the debt instrument over its adjusted issue price. For this purpose, the adjustment is translated into functional currency at the spot rate on the date the instrument was acquired (,1 = $1). Accordingly, Z=s adjusted basis in the debt instrument at maturity is $1443.66 ($1686.90 - $243.24).

(D) Amount realized. Even though Z receives ,1400 at maturity, for purposes of determining the amount realized, Z is treated under paragraph (b)(2)(v) of this section as receiving the projected amount of the contingent payment on December 31, 2006, reduced by the amount of Z's negative adjustment carryforward of ,5.01. Therefore, Z is treated as receiving ,1344.69 (,1349.70 - ,5.01) on December 31, 2006. Under paragraph (b)(3)(iv) of this section, Z translates its amount realized into dollars and computes its gain or loss on the instrument (other than foreign currency gain or loss) by breaking the amount realized into its component parts. Accordingly, ,59.54 of the ,1344.69 (representing the interest accrued in 2005) is translated at the rate at which it was accrued (,1 = $1.50), resulting in an amount realized of $89.31; ,62.59 of the ,1344.69 (representing the interest accrued in January-June 2006) is translated into dollars at the rate at which it was accrued (,1 = $1.50), resulting in an amount realized of $93.89; ,65.80 of the ,1344.69 (representing the interest accrued in July-December 2006) is translated into dollars at the rate at which it was accrued (,1 = $1.50), resulting in an amount realized of $98.70; and ,1156.76 of the ,1344.69 (representing a return of principal) is translated into dollars at the spot rate on the date the instrument was purchased (,1 = $1), resulting in an amount realized of $1156.76. Z's

amount realized is $1438.66 ($89.31 + $93.89 + $98.70 + $1156.76), and Z recognizes a capital loss (before consideration of foreign currency gain or loss) of $5 on retirement of the instrument ($1438.66 - $1443.66 = -$5).

(E) Foreign currency gain or loss. Z recognizes foreign currency gain under section 988 on the instrument with respect to the entire consideration actually received at maturity, ,1400. While foreign currency gain or loss ordinarily would not have arisen with respect to ,50.30 of the ,1400, which was initially treated as a positive adjustment in 2006, the larger negative adjustment in 2006 reduced this positive adjustment to zero. Accordingly, foreign currency gain or loss is recognized with respect to the entire ,1400. Under paragraph (b)(5)(ii) of this section, however, no foreign currency gain or loss is recognized with respect to unpaid accrued interest reduced to zero by the net negative adjustment resulting in 2006, and no foreign currency gain or loss is recognized with respect to unpaid accrued interest from 2005, also reduced to zero by the ordinary loss. Therefore, the entire ,1400 is treated as a return of principal for the purpose of determining foreign currency gain or loss, and Z recognizes a total foreign currency gain on December 31, 2001, of $1400 [,1400 x ($2.00 - $1.00)].

(F) Source. Z has an ordinary loss of $89.31, a capital loss of $5, and a foreign currency gain of $1400. Under paragraph (b)(6) of this section and '1.1275-4(b)(9)(iv), the $89.31 ordinary loss generally reduces Z=s foreign source passive income under section 904(d) and the regulations thereunder. Under paragraph (b)(6) of this section and '1.865-1(b)(2), the $5 capital loss is sourced by reference to how interest income on the instrument would have been sourced. Therefore, the $5 capital loss generally reduces Z=s foreign source passive income under section 904(d) and the regulations thereunder. Under paragraph (b)(6) of this section and '1.988-4, Z=s foreign currency gain of $1400 is sourced by reference to Z's residence and is therefore from sources within the United States.

Example 5. Sale of an instrument with a negative adjustment carryforwardB-(i) Facts. On December 31, 2003, Z, a calendar year U.S. resident taxpayer whose functional currency is the U.S. dollar, purchases at original issue a debt instrument with non-currency contingencies for ,1000. All payments of principal and interest with respect to the instrument are denominated in, or determined by reference to, a single nonfunctional currency (the British pound). The debt instrument would be subject to '1.1275-

4(b) if it were denominated in dollars. The debt instrument's comparable yield, determined in British pounds under ''1.988-2(b)(2) and 1.1275-4(b), is 10 percent, compounded annually, and the projected payment schedule for the debt instrument provides for payments of ,310 on December 31, 2005 (consisting of a noncontingent payment of ,50 and a projected amount of ,260) and ,990 on December 31, 2006 (consisting of a noncontingent payment of ,940 and a projected amount of ,50). The debt instrument is a capital asset in the hands of Z. Z does not elect to use the spot-rate convention described in '1.988-2(b)(2)(iii)(B). The payment actually made on December 31, 2005, is ,50. On December 30, 2006, Z sells the debt instrument for ,940. The relevant pound/dollar spot rates over the term of the instrument are as follows:

Date	Spot rate (pounds to dollars)
Dec. 31, 2003	,1.00=$ 1.00
Dec. 31, 2005	,1.00=$ 2.00
Dec. 30, 2006	,1.00=$ 2.00

Accrual period	Average rate (pounds to dollars)
January 1 - December 31, 2004	,1.00=$ 2.00
January 1 - December 31, 2005	,1.00=$ 2.00
January 1 - December 31, 2006	,1.00=$ 2.00

(ii) Treatment in 2004--(A) Determination of accrued interest. Under paragraph (b)(2)(i) of this section, and based on the comparable yield, Z accrues ,100 of interest on the debt instrument for 2004 (issue price of ,1000 x 10 percent). Under paragraph (b)(3)(i) of this section, Z translates the ,100 at the average exchange rate for the accrual period ($2.00 x ,100 = $200). Accordingly, Z has interest income in 2004 of $200.

(B) Adjusted issue price and basis. Under paragraphs (b)(2)(iii) and (iv) of this section, the adjusted issue price of the debt instrument determined in pounds and Z's adjusted basis in dollars in the debt instrument are increased by the interest accrued in 2004. Thus, on January 1, 2005, the adjusted issue price of the debt instrument is ,1100. For purposes of determining Z's dollar basis in the debt instrument, the $1000 basis ($1.00 x ,1000 original cost basis) is increased by the ,100 of accrued interest, translated at the rate at which

interest was accrued for 2004. See paragraph (b)(3)(iii) of this section. Accordingly, Z's adjusted basis in the debt instrument as of January 1, 2005, is $1200 ($1000 + $200).

(iii) Treatment in 2005--(A) Determination of accrued interest. Under paragraph (b)(2)(i) of this section, and based on the comparable yield, Z's accrued interest for 2005 is ,110 (adjusted issue price of ,1100 x 10 percent). Under paragraph (b)(3)(i) of this section, the ,110 of accrued interest is translated at the average exchange rate for the accrual period ($2.00 x ,110 = $220).

(B) Effect of net negative adjustment. The payment actually made on December 31, 2005, is ,50, rather than the projected ,310. Under paragraph (b)(2)(ii) of this section, Z has a net negative adjustment of ,260 on December 31, 2005, attributable to the difference between the amount of the actual payment and the amount of the projected payment. Z's accrued interest income of ,110 in 2005 is reduced to zero by the net negative adjustment. Under paragraph (b)(3)(ii)(B)(1) of this section, the net negative adjustment which reduces the current year=s interest is not translated into functional currency. Under paragraph (b)(2)(ii) of this section, Z treats the remaining ,150 net negative adjustment as an ordinary loss to the extent of the ,100 previously accrued interest in 2004. This ,100 ordinary loss is attributable to interest accrued but not paid in the preceding year. Therefore, under paragraph (b)(3)(ii)(B)(2) of this section, Z translates the loss into dollars at the average rate for such year (,1 = $2.00). Accordingly, Z has an ordinary loss of $200 in 2005. The remaining ,50 of net negative adjustment is a negative adjustment carryforward under paragraph (b)(2)(ii) of this section.

(C) Adjusted issue price and basis. Based on the projected payment schedule, the adjusted issue price of the debt instrument on January 1, 2006 is ,900, i.e., the adjusted issue price of the debt instrument on January 1, 2005 (,1100), increased by the interest accrued in 2005 (,110), and decreased by the projected amount of the December 31, 2005, payment (,310). See paragraph (b)(2)(iii) of this section. Z=s adjusted basis on January 1, 2006 is Z=s adjusted basis on January 1, 2005 ($1200), increased by the functional currency amount of interest accrued in 2005 ($220), and decreased by the amount of the payments made in 2005, based solely on the projected payment schedule, (,310). The amount of the projected payment is first attributable to the interest accrued in 2005 (,110), and then to the interest accrued

in 2004 (,100), and the remaining amount to principal (,100). The interest component of the projected payment is translated into functional currency at the rates at which it was accrued, and the principal component of the projected payment is translated into functional currency at the spot rate on the date the instrument was issued. See paragraph (b)(3)(iii) of this section. Accordingly, Z=s adjusted basis in the debt instrument, following the increase of adjusted basis for interest accrued in 2005 ($1200 + $220 = $1420), is decreased by $520 ($220 + $200 + $100 = $520). Z=s adjusted basis on January 1, 2006 is therefore, $900.

(D) Foreign currency gain or loss. Z will recognize foreign currency gain on the receipt of the ,50 payment actually received on December 31, 2005. Based on paragraph (b)(5)(iv) of this section, the ,50 payment is attributable to principal since the accrued unpaid interest was completely eliminated by the net negative adjustment. The amount of foreign currency gain is determined, under paragraph (b)(5)(iii) of this section, by reference to the difference between the spot rate on the date the ,50 payment was made and the spot rate on the date the debt instrument was issued. Accordingly, Z recognizes $50 of foreign currency gain on the ,50 payment. [($2.00 - $1.00) x ,50 =$50]. Under paragraph (b)(6) of this section and '1.988-4, Z=s foreign currency gain of $50 is sourced by reference to Z's residence and is therefore from sources within the United States.

(iv) Treatment in 2006--(A) Determination of accrued interest. Under paragraph (b)(2)(i) of this section, and based on the comparable yield, Z accrues ,90 of interest on the debt instrument for 2006 (adjusted issue price of ,900 x 10 percent). Under paragraph (b)(3)(i) of this section, Z translates the ,90 at the average exchange rate for the accrual period ($2.00 x ,90 = $180). Accordingly, prior to taking into account the 2005 negative adjustment carryforward, Z has interest income in 2006 of $180.

(B) Effect of net negative adjustment. The ,50 negative adjustment carryforward from 2005 is a negative adjustment for 2006. Since there are no other positive or negative adjustments, there is a ,50 negative adjustment in 2006 which reduces Z=s accrued interest income by ,50. Accordingly, after giving effect to the ,50 negative adjustment carryforward, Z will accrue $80 of interest income. [(,90-,50) x $2.00 = $80]

(C) Adjusted issue price. Under paragraph (b)(2)(iii) of this section, the adjusted issue price of the debt instrument determined in pounds is increased by the interest accrued in 2006 (prior to taking into account the negative adjustment carryforward). Thus, on December 30, 2006, the adjusted issue price of the debt instrument is ,990.

(D) Adjusted basis. For purposes of determining Z's dollar basis in the debt instrument, Z=s $900 adjusted basis on January 1, 2006, is increased by the accrued interest, translated at the rate at which interest was accrued for 2006. See paragraph (b)(3)(iii)(A) of this section. Note, however, that under paragraph (b)(3)(iii)(B) of this section the amount of accrued interest which is reduced as a result of the negative adjustment carryforward, i.e., ,50, is treated for purposes of this section as principal, and is translated at the spot rate on the date the instrument was issued, i.e., ,1.00 =$1.00. Accordingly, Z's adjusted basis in the debt instrument as of December 30, 2006, is $1030 ($900 + $50 + $80).

(E) Amount realized. Z=s amount realized in denomination currency is ,940, i.e., the amount of pounds Z received on the sale of the debt instrument. Under paragraph (b)(3)(iv)(B)(1) of this section, Z=s amount realized is first translated by reference to the principal component of basis (including the amount which is treated as principal under paragraph (b)(3)(iii)(B) of this section) and then the remaining amount realized, if any, is translated by reference to the accrued unpaid interest component of adjusted basis. Thus, ,900 of Z=s amount realized is translated by reference to the principal component of adjusted basis. The remaining ,40 of Z=s amount realized is treated as principal under paragraph (b)(3)(iii)(B) of this section, and is also is translated by reference to the principal component of adjusted basis. Accordingly, Z=s amount realized in functional currency is $940. (No part of Z=s amount realized is attributable to the interest accrued on the debt instrument.) Z realizes a loss of $90 on the sale of the debt instrument ($1030 basis - $940 amount realized). Under paragraph (b)(4) of this section and '1.1275-4(b)(8), $80 of the loss is characterized as ordinary loss, and the remaining $10 of loss is characterized as capital loss. Under ''1.988-6(b)(6) and 1.1275-4(b)(9)(iv) the $80 ordinary loss is treated as a deduction that is definitely related to the interest income accrued on the debt instrument. Similarly, under ''1.988-6(b)(6) and 1.865-1(b)(2) the $10 capital loss is also allocated to the interest income from the debt instrument.

(F) Foreign currency gain or loss. Z recognizes foreign currency gain with respect to the ,940 he received on the sale of the debt instrument. Under paragraph (b)(5)(iv) of this section, the ,940 Z received is attributable to principal (and the amount which is treated as principal under paragraph (b)(3)(iii)(B) of this section). Thus, Z recognizes foreign currency gain on December 31, 2006, of $940. [($2.00-$1.00) x ,940]. Under paragraph (b)(6) of this section and '1.988-4, Z=s foreign currency gain of $940 is sourced by reference to Z's residence and is therefore from sources within the United States.

(d) Multicurrency debt instruments--(1) In general. Except as provided in this paragraph (d), a multicurrency debt instrument described in paragraph (a)(1)(ii) or (iii) of this section shall be treated as an instrument described in paragraph (a)(1)(i) of this section and shall be accounted for under the rules of paragraph (b) of this section. Because payments on an instrument described in paragraph (a)(1)(ii) or (iii) of this section are denominated in, or determined by reference to, more than one currency, the issuer and holder or holders of the instrument are required to determine the denomination currency of the instrument under paragraph (d)(2) of this section before applying the rules of paragraph (b) of this section.

(2) Determination of denomination currency--(i) In general. The denomination currency of an instrument described in paragraph (a)(1)(ii) or (iii) of this section shall be the predominant currency of the instrument. Except as otherwise provided in paragraph (d)(2)(ii) of this section, the predominant currency of the instrument shall be the currency

with the greatest value determined by comparing the functional currency value of the noncontingent and projected payments denominated in, or determined by reference to, each currency on the issue date, discounted to present value (in each relevant currency), and translated (if necessary) into functional currency at the spot rate on the issue date. For this purpose, the applicable discount rate may be determined using any method, consistently applied, that reasonably reflects the instrument's economic substance. If a taxpayer does not determine a discount rate using such a method, the Commissioner may choose a method for determining the discount rate that does reflect the instrument's economic substance. The predominant currency is determined as of the issue date and does not change based on subsequent events (e.g., changes in value of one or more currencies).

(ii) Difference in discount rate of greater than 10 percentage points. This §1.988-6(d)(2)(ii) applies if no currency has a value determined under paragraph (d)(2)(i) of this section that is greater than 50% of the total value of all payments. In such a case, if the difference between the discount rate in the denomination currency otherwise determined under (d)(2)(i) of this section and the discount rate determined under paragraph (d)(2)(i) of this section with respect to any other currency in which payments are made (or determined by

reference to) pursuant to the instrument is greater than 10 percentage points, then the Commissioner may determine the predominant currency under any reasonable method.

(3) Issuer/holder consistency. The issuer determines the denomination currency under the rules of paragraph (d)(2) of this section and provides this information to the holders of the instrument in a manner consistent with the issuer disclosure rules of '1.1275-2(e). If the issuer does not determine the denomination currency of the instrument, or if the issuer=s determination is unreasonable, the holder of the instrument must determine the denomination currency under the rules of paragraph (d)(2) of this section. A holder that determines the denomination currency itself must explicitly disclose this fact on a statement attached to the holder=s timely filed federal income tax return for the taxable year that includes the acquisition date of the instrument.

(4) Treatment of payments in currencies other than the denomination currency. For purposes of applying the rules of paragraph (b) of this section to debt instruments described in paragraph (a)(1)(ii) or (iii) of this section, payments not denominated in (or determined by reference to) the denomination currency shall be treated as non-currency-related contingent payments. Accordingly, if the denomination currency of the instrument is determined to be the taxpayer=s functional

currency, the instrument shall be accounted for under '1.1275-4(b) rather than under this section.

(e) Instruments issued for nonpublicly traded property--(1) Applicability. This paragraph (e) applies to debt instruments issued for nonpublicly traded property that would be described in paragraph (a)(1)(i), (ii), or (iii) of this section, but for the fact that such instruments are described in '1.1275-4(c)(1) rather than '1.1275-4(b)(1). For example, this paragraph (e) generally applies to a contingent payment debt instrument denominated in a nonfunctional currency that is issued for non-publicly traded property. Generally the rules of '1.1275-4(c) apply except as set forth by the rules of this paragraph (e).

(2) Separation into components. An instrument described in this paragraph (e) is not accounted for using the noncontingent bond method of '1.1275-4(b) and paragraph (b) of this section. Rather, the instrument is separated into its component payments. Each noncontingent payment or group of noncontingent payments which is denominated in a single currency shall be considered a single component treated as a separate debt instrument denominated in the currency of the payment or group of payments. Each contingent payment shall be treated separately as provided in paragraph (e)(4) of this section.

(3) Treatment of components consisting of one or more noncontingent payments in the same currency. The issue price of

each component treated as a separate debt instrument which consists of one or more noncontingent payments is the sum of the present values of the noncontingent payments contained in the separate instrument. The present value of any noncontingent payment shall be determined under '1.1274-2(c)(2), and the test rate shall be determined under '1.1274-4 with respect to the currency in which each separate instrument is considered denominated. No interest payments on the separate debt instrument are qualified stated interest payments (within the meaning of '1.1273-1(c)) and the de minimis rules of section 1273(a)(3) and '1.1273-1(d) do not apply to the separate debt instrument. Interest income or expense is translated, and exchange gain or loss is recognized on the separate debt instrument as provided in '1.988-2(b)(2), if the instrument is denominated in a nonfunctional currency.

(4) Treatment of components consisting of contingent payments --(i) General rule. A component consisting of a contingent payment shall generally be treated in the manner provided in '1.1275-4(c)(4). However, except as provided in paragraph (e)(4)(ii) of this section, the test rate shall be determined by reference to the U.S. dollar unless the dollar does not reasonably reflect the economic substance of the contingent component. In such case, the test rate shall be determined by reference to the currency which most reasonably reflects the

economic substance of the contingent component. Any amount received in nonfunctional currency from a component consisting of a contingent payment shall be translated into functional currency at the spot rate on the date of receipt. Except in the case when the payment becomes fixed more than six months before the payment is due, no foreign currency gain or loss shall be recognized on a contingent payment component.

(ii) Certain delayed contingent payments--(A) Separate debt instrument relating to the fixed component. The rules of '1.1275-4(c)(4)(iii) shall apply to a contingent component the payment of which becomes fixed more than 6 months before the payment is due. For this purpose, the denomination currency of the separate debt instrument relating to the fixed payment shall be the currency in which payment is to be made and the test rate for such separate debt instrument shall be determined in the currency of that instrument. If the separate debt instrument relating to the fixed payment is denominated in nonfunctional currency, the rules of '1.988-2(b)(2) shall apply to that instrument for the period beginning on the date the payment is fixed and ending on the payment date.

(B) Contingent component. With respect to the contingent component, the issue price considered to have been paid by the issuer to the holder under '1.1275-4(c)(4)(iii)(A) shall be translated, if necessary, into the functional currency of the

issuer or holder at the spot rate on the date the payment becomes fixed.

(5) Basis different from adjusted issue price. The rules of '1.1275-4(c)(5) shall apply to an instrument subject to this paragraph (e).

(6) Treatment of a holder on sale, exchange, or retirement. The rules of '1.1275-4(c)(6) shall apply to an instrument subject to this paragraph (e).

(f) Rules for nonfunctional currency tax exempt obligations described in '1.1275-4(d)--(1) In general. Except as provided in paragraph (f)(2) of this section, section 1.988-6 shall not apply to a debt instrument the interest on which is excluded from gross income under section 103(a).

(2) Operative rules. [RESERVED].

(g) Effective date. This section shall apply to debt instruments issued on or after October 29, 2004.

Par. 5. In §1.1275-2, paragraph (g)(1) is amended by adding a sentence at the end of the paragraph to read as follows:

§1.1275-2 Special rules relating to debt instruments.

* * * * * *

(g) * * * (1) * * * See also §1.988-2(b)(18) for debt instruments with payments denominated in (or determined by

reference to) a currency other than the taxpayer’s functional currency.

* * * * *

Par. 6. In '1.1275-4, paragraph (a)(2)(iv) is revised to read as follows:

'1.1275-4 Contingent payment debt instruments.

(a)* * *

(2)* * *

(iv) A debt instrument subject to section 988 (except as provided in '1.988-6);

* * * * *

PART 602--OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 7. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 8. Section 601.101, paragraph (b) is amended by adding an entry to the table in numerical order to read, in part,as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.988-6	1545-1831
* * * * *	

Nancy Jardine,
Acting Deputy Commissioner of Services and Enforcement.

Approved: July 16, 2004.

Gregory F. Jenner,
Acting Assistant Secretary of the Treasury.

Internal Revenue Bulletin: 2012-38

September 17, 2012

T.D. 9598

Integrated Hedging Transactions of Qualifying Debt

Table of Contents

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

AGENCY:

Internal Revenue Service (IRS), Treasury.

ACTION:

Temporary and final regulations.

SUMMARY:

This document contains temporary regulations that address certain integrated transactions that involve a foreign currency denominated debt instrument and multiple associated hedging transactions. The regulations provide that if a taxpayer has identified multiple hedges as being part of a qualified hedging transaction, and the taxpayer has terminated at least one but less than all of the hedges (including a portion of one or more of the hedges), the taxpayer must treat the remaining hedges as having been sold for fair market value on the date of disposition of the terminated hedge. The text of the temporary regulations also serves as the text of the proposed regulations (REG-138489-09) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES:

Effective Date: These regulations are effective on September 6, 2012.

Applicability Date: These regulations apply to leg-outs within the meaning of §1.988-5(a)(6)(ii) which occur on or after September 6, 2012.

FOR FURTHER INFORMATION CONTACT:

Sheila Ramaswamy, at (202) 622-3870 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 1.988-5 provides detailed rules that permit the integration of a qualifying debt instrument with a §1.988-5(a) hedge. The effect of integration under the regulations is to create a synthetic debt instrument. Generally, if a taxpayer enters into a qualified hedging transaction and meets the requirements of the regulations, no exchange gain or loss is recognized on the debt instrument or the hedge for the period that it is part of a qualified hedging transaction (provided that the synthetic debt instrument is not denominated in a nonfunctional currency). See §1.988-5(a)(9). A qualified hedging transaction is an integrated economic transaction consisting of a qualifying debt instrument and a §1.988-5(a) hedge. See §1.988-5(a)(1). A qualifying debt instrument is any debt instrument described in §1.988-1(a)(2)(i) regardless of its denominated currency. See §1.988-5(a)(3). A §1.988-5(a) hedge is a spot contract, futures contract, forward contract, option contract, notional principal contract, currency swap contract, or similar financial instrument, or series or combinations of such instruments, that when integrated with a qualifying debt instrument permits the calculation of a yield to maturity in the currency in which the synthetic debt instrument is denominated. See §1.988-5(a)(4).

Under §1.988-5(a)(6)(ii), a taxpayer that disposes of all or a part of the qualifying debt instrument or hedge prior to the maturity of the qualified hedging transaction, or that changes a material term of the qualifying debt instrument or hedge, is viewed as “legging out” of integrated treatment. One of the consequences of legging out is that if the hedge is disposed of, the qualifying debt instrument is treated as sold for its fair market value on the date of disposition of the hedge (leg-out date). See §1.988-5(a)(6)(ii)(B). Any gain or loss on the qualifying debt instrument from the date of identification to the leg-out date is recognized on the leg-out date. The intended result of this deemed disposition rule is that the gain or loss on the qualifying debt instrument will generally be offset by the gain or loss on the hedge.

The Internal Revenue Service (IRS) and the Department of the Treasury (Treasury Department) have become aware that some taxpayers who are in a loss position with respect to a qualifying debt instrument that is part of a qualified hedging transaction are interpreting the legging-out rules of §1.988-5(a)(6)(ii)(B) to permit the recognition of the loss on the debt instrument without recognition of all of the corresponding gain on the hedging component of the transaction. Taxpayers claim to achieve this result by hedging nonfunctional currency debt instruments with multiple financial instruments and selectively disposing of less than all of these positions. Taxpayers take the position that §1.988-5(a)(6)(ii)(B) triggers the entire loss in the qualifying debt instrument but not the gain in the remaining components of the hedging side of the integrated transaction.

For example, a taxpayer may fully hedge a fixed rate nonfunctional currency denominated debt instrument that it has issued with two swaps—a nonfunctional currency/dollar currency swap and a fixed for floating dollar interest rate swap. The effect of matching the currency swap with the foreign currency denominated debt is to create synthetic fixed rate U.S. dollar debt while the effect of the interest rate swap is to simultaneously transform the synthetic fixed rate U.S. dollar debt into synthetic floating rate U.S. dollar debt. Thus, assuming that the rules of §1.988-5(a) are otherwise satisfied, the taxpayer will have effectively converted the fixed rate foreign currency denominated debt instrument into a synthetic floating rate U.S. dollar denominated debt instrument.

As the U.S. dollar declines in value relative to the foreign currency in which the debt instrument is denominated, the taxpayer disposes of the interest rate swap while keeping the currency swap in existence. The taxpayer takes the position that the disposition of the interest rate swap allows it to treat the debt instrument as having been terminated on the date of disposition and claims a loss on the debt instrument without taking into account the offsetting gain on the remaining component of the hedge. Thus, the taxpayer claims the transaction generates a net loss. The IRS and the Treasury Department believe that these results are inappropriate under the legging-out rules since the claimed loss is largely offset by unrealized gain on the remaining component of the hedging transaction. Therefore, the IRS and the Treasury Department are issuing these regulations to clarify the rules regarding the consequences of legging-out of qualified hedging transactions that consist of multiple components. No inference is intended regarding the merits of the position taken by the taxpayer with respect to the transaction described above (or comparable positions taken by taxpayers with respect to similar transactions) in the case of transactions occurring prior to the applicability date of these regulations, and in appropriate cases the IRS may challenge the claimed results.

Explanation of Provisions

Section 1.988-5(a) is amended to provide that if a hedge with more than one component has been properly identified as being part of a qualified hedging transaction, and at least one but not all of the components of the hedge that is a part of the qualified hedging transaction has been terminated or disposed of, all of the remaining components of the hedge (as well as the qualifying debt) shall be treated as sold for their fair market value on the leg-out date of the terminated hedge. Similarly, if a part of any component of a hedge (whether a hedge consists of a single or multiple components) has been disposed of, the remaining part of that component (as well as other components in the case of a hedge with multiple components) that is still in existence (as well as the qualifying debt instrument) shall be treated as sold for its fair market value on the leg-out date of the terminated hedge.

Effective/Applicability Date

The regulation applies to leg-outs within the meaning of §1.988-5(a)(6)(ii) which occur on or after September 6, 2012.

Special Analyses

It has been determined that these regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Amendment to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.988-5 is amended by:

1. Revising paragraph (a)(6)(ii).

2. Adding *Example 11* in paragraph (a)(9)(iv).

The revision and addition read as follows:

§1.988-5 Section 988(d) hedging transactions.

(a) * * *

(6) * * *

(ii) [Reserved]. For further guidance, see §1.988-5T(a)(6)(ii).

* * * * *

(9) * * *

(iv) * * *

Example 11. [Reserved]. For further guidance, see §1.988-5T(a)(9)(iv).

Example 11.

* * * * *

Par. 3. Section 1.988-5T is added to read as follows:

§1.988-5T Section 988(d) hedging transactions (temporary).

(a) through (a)(6)(i) [Reserved]. For further guidance, see §1.988-5(a) through (a)(6)(i).

(ii) *Legging out.* With respect to a qualifying debt instrument and hedge that are properly identified as a qualified hedging transaction, “legging out” of integrated treatment under this paragraph (a) means that the taxpayer disposes of or otherwise terminates all or any portion of the qualifying debt instrument or the hedge prior to maturity of the qualified hedging transaction, or the taxpayer changes a material term of the qualifying debt instrument (for example, exercises an option to change the interest rate or index, or the maturity date) or the hedge (for example, changes the interest or exchange rates underlying the hedge, or the expiration date) prior to maturity of the qualified hedging transaction. A taxpayer that disposes of or terminates a qualified hedging transaction (that is, disposes of or terminates both the qualifying debt instrument and the hedge in their entirety on the same day) shall be considered to have disposed of or otherwise terminated the synthetic debt instrument rather than legging out. If a taxpayer legs out of integrated treatment, the following rules shall apply:

(A) The transaction will be treated as a qualified hedging transaction during the time the requirements of this paragraph (a) were satisfied.

(B) If all of the instruments comprising the hedge (each such instrument, a component) are disposed of or otherwise terminated, the qualifying debt instrument shall be treated as sold for its fair market value on the date the hedge is disposed of or otherwise terminated (the leg-out date), and any gain or loss (including gain or loss resulting from factors other than movements in exchange rates) from the identification date to the leg-out date is realized and recognized on the leg-out date. The spot rate on the leg-out date shall be used to determine exchange gain or loss on the debt instrument for the period beginning on the leg-out date and ending on the date such instrument matures or is disposed of or otherwise terminated. Proper adjustment must be made to reflect any gain or loss taken into account. The netting rule of §1.988-2(b)(8) shall apply.

(C) If a hedge has more than one component (and such components have been properly identified as being part of the qualified hedging transaction) and at least one but not all of the components that comprise the hedge has been disposed of or otherwise terminated, or if part of any component of the hedge has been terminated (whether a hedge consists of a single or multiple components), the date such component (or part thereof) is disposed of or terminated shall be considered the leg-out date and the qualifying debt instrument shall be treated as sold for its fair market value in accordance with the rules of paragraph (a)(6)(ii)(B) of this section on such leg-out date. In addition, all of the remaining components (or parts thereof) that have not been disposed of or otherwise terminated shall be treated as sold for their fair market value on the leg-out date, and any gain or loss from the identification date to the leg-out date is realized and recognized on the leg-out date. To the extent relevant, the spot rate on the leg-out date shall be used to determine exchange gain or loss on the remaining components (or parts thereof) for the period beginning on the leg-out date and ending on the date such components (or parts thereof) are disposed of or otherwise terminated.

(D) If the qualifying debt instrument is disposed of or otherwise terminated in whole or in part, the date of such disposition or termination shall be considered the leg-out date. Accordingly, the hedge (including all components making up the hedge in their entirety) that is part of the qualified hedging transaction shall be treated as sold for its fair market value on the leg-out date, and any gain or loss from the identification date to the leg-out date is realized and recognized on the leg-out date. To the extent relevant, the spot rate on the leg-out date shall be used to determine exchange gain or loss on the hedge (including all components thereof) for the period beginning on the leg-out date and ending on the date such hedge is disposed of or otherwise terminated.

(E) Except as provided in paragraph (a)(8)(iii) of this section (regarding identification by the Commissioner), the part of the qualified hedging transaction that has not been terminated (that is, the remaining debt instrument in its entirety even if partially hedged, or the remaining components of the hedge) cannot be part of a qualified hedging transaction for any period subsequent to the leg-out date.

(F) If a taxpayer legs out of a qualified hedging transaction and realizes a gain with respect to the disposed of or terminated debt instrument or hedge, then paragraph (a)(6)(ii)(B), (C), and (D) of this section, as appropriate, will not apply if during the period beginning 30 days before the leg-out date and ending 30 days after that date the taxpayer enters into another transaction that, taken together with any remaining components of the hedge, hedges at least 50 percent of the remaining currency flow with respect to the qualifying debt instrument that was part of the qualified hedging transaction or, if appropriate, an equivalent amount under the hedge (or any remaining components thereof) that was part of the qualified hedging transaction. Similarly, in a case in which a hedge has multiple components that are part of a qualified hedging transaction, if the taxpayer legs out of a qualified hedging transaction by terminating one such component or a part of one or more such components and realizes a gain with respect to the terminated component, components, or portions thereof, then paragraphs (a)(6)(ii)(B), (C), and (D) of this section, as appropriate, will not apply if the remaining components of the hedge (including parts thereof) by themselves hedge at least 50 percent of the remaining currency flow with respect to the qualifying debt instrument that was part of the qualified hedging transaction.

(a)(7) through (a)(9)(iv) *Examples 10* [Reserved]. For further guidance, see §1.988-5(a)(7) through (a)(9)(iv) *Example 10*.

Example 11. (i) K is a U.S. corporation with the U.S. dollar as its functional currency. On January 1, 2013, K borrows 100 British pounds (£) for two years at a 10% rate of interest payable on December 31 of each year with no principal payment due until maturity on December 31, 2014. Assume that the spot rate on January 1, 2013, is £1=$1. On the same date, K enters into two swap contracts with an unrelated counterparty that economically results in the transformation of the fixed rate £100 borrowing to a floating rate dollar borrowing. The terms of the swaps are as follows:

(A) *Swap #1, Currency swap*. On January 1, 2013, K will exchange £100 for $100.

(*1*) On December 31 of both 2013 and 2014, K will exchange $8 for £10;

(*2*) On December 31, 2014, K will exchange $100 for £100.

(B) *Swap #2, Interest rate swap*. On December 31 of both 2013 and 2014, K will pay LIBOR times a notional principal amount of $100 and will receive 8% times the same $100 notional principal amount.

(ii) Assume that K properly identifies the pound borrowing and the swap contracts as a qualified hedging transaction as provided in paragraph (a)(8) of this section and that the other relevant requirements of paragraph (a) of this section are satisfied.

(iii) Assume also that on January 1, 2014, the spot exchange rate is £1:$2; the U.S. dollar LIBOR rate of interest is 9%; and the market value of K's note in pounds has not changed. K terminates swap #2. K will incur a loss of ($.91) (the present value of $1) with respect to the termination of such swap on January 1, 2014. Pursuant to paragraph (a)(6)(ii)(C) of this section, K must treat swap #1 as having been sold for its fair market value on the leg-out date, which is the date swap #2 is terminated. K must realize and recognize gain of $100.92 [the present value of £110 discounted in pounds to equal £100 x $2 ($200) less the present value of $108 ($99.08)]. The loss inherent in the pound borrowing from January 1, 2013 to January 1, 2014 is realized and recognized on January 1, 2014. Such loss is exchange loss in the amount of $100 [the present value of £110 that was to be paid at the end of the year discounted at pound interest rates to equal £100 times the change in exchange rates: (£100 x $1, the spot rate on January 1, 2013) - (£100 x $2, the spot rate on January 1, 2014)]. Except as provided in paragraph (a)(8)(iii) of this section (regarding identification by the Commissioner), the pound borrowing and currency swap cannot be part of a qualified hedging transaction for any period subsequent to the leg-out date.

(iv) Assume the facts are the same as in paragraph (iii) of this section except that on January 1, 2014, the U.S. dollar LIBOR rate of interest is 7% rather than 9%. When K terminates swap #2, K will realize gain of $0.93 (the present value of $1) received with respect to the termination on January 1, 2014. Fifty percent or more of the remaining pound cash flow of the pound borrowing remains hedged after the termination of swap #2. Accordingly, under paragraph (a)(6)(ii)(F) of this section, paragraphs (a)(6)(ii)(B) and (C) of this section do not apply and the gain on swap #1 and the loss on the qualifying debt instrument is not taken into account. Thus, K will include in income $0.93 realized from termination of swap #2.

(a)(10) through (g) [Reserved]. For further guidance, see §1.988-5(a)(10) through (g).

(h) *Effective/applicability date*. This section applies to leg-outs that occur on or after September 6, 2012.

(i) *Expiration date*. This section expires on September 4, 2015.

Steven T. Miller,
Deputy Commissioner for
Services and Enforcement.

Approved August 17, 2012.

Mark J. Mazur,
Assistant Secretary
of the Treasury (Tax Policy).

Note

(Filed by the Office of the Federal Register on September 5, 2012, 8:45 a.m., and published in the issue of the Federal Register for September 6, 2012, F.R. 54808)

Drafting Information

The principal author of these regulations is Sheila Ramaswamy, Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Internal Revenue Bulletin: 2015-39

September 28, 2015

T.D. 9736

Integrated Hedging Transactions of Qualifying Debt

Table of Contents

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

AGENCY:

Internal Revenue Service (IRS), Treasury.

ACTION:

Final regulations and removal of temporary regulations

SUMMARY:

This document contains final regulations that address certain integrated transactions that involve a foreign currency denominated debt instrument and multiple associated hedging transactions. The regulations provide that if a taxpayer has identified multiple hedges as being part of a qualified hedging transaction, and the taxpayer has terminated at least one but less than all of the hedges (including a portion of one or more of the hedges), the taxpayer must treat the remaining hedges as having been sold for fair market value on the date of disposition of the terminated hedge.

DATES:

Effective Date. These regulations are effective on September 8, 2015.

Applicability Date. These regulations apply to leg-outs within the meaning of § 1.988–5(a)(6)(ii) that occur on or after September 6, 2012.

FOR FURTHER INFORMATION CONTACT:

Sheila Ramaswamy, at (202) 317-6938 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On September 5, 2012, the Treasury Department and the IRS issued temporary regulations (TD 9598) (the “Temporary Regulations”) that revised the legging out rules of § 1.988–5(a)(6)(ii) applicable to hedging transactions under section 988(d). No public hearing was requested or held. One comment was received, which is available at *www.regulations.gov* or upon request. After consideration of the comment, the Temporary Regulations are adopted as final regulations without substantive change. The Temporary Regulations are removed.

Summary of Comments and Explanation of Revisions

The only comment received on the Temporary Regulations suggested that the promulgation of the Temporary Regulations was unnecessary because the prior regulations did not support the taxpayer reporting position that the Temporary Regulations were designed to prevent. The comment considered the taxpayer position addressed in the Temporary Regulations to be inconsistent with both the purposes of section 988(d) and the economic substance of the transaction. Although the comment finds the Temporary Regulations ultimately unnecessary, it acknowledges that the section 988 hedging rules are a complicated area of law and that the prior regulations could be improved to provide greater certainty to taxpayers. The Treasury Department and the IRS have determined that the Temporary Regulations are useful in clarifying the section 988(d) integration rules — as well as in preventing unintended approaches to legging out under those rules — and thus should be adopted as final.

The comment recommended that the Treasury Department and the IRS consider aligning the hedge integration regime under section 988 with the approach taken in regulations under section 1275 on the basis that the section 1275 approach is more consistent with economic reality. The § 1.1275–6 regulations generally allow the integration of a qualifying debt instrument with a hedge or combination of hedges if the combined cash flows of the components are substantially equivalent to the cash flows on a fixed or variable rate debt instrument. However, a financial instrument that hedges currency risk cannot be integrated as a § 1.1275–6 hedge. *See* § 1.1275–6(b)(2). Under the legging out rules of § 1.1275–6, a taxpayer that legs out of an integrated transaction is treated as terminating the synthetic debt instrument for its fair market value and recognizing any gain or loss. If the taxpayer remains liable on the qualifying debt instrument after the leg-out, adjustments are made to reflect any difference between the fair market value of the qualifying debt instrument and its adjusted issue price. If the taxpayer remains a party to the § 1.1275–6 hedge, the hedge is treated as entered into at its fair market value. By contrast, subject to § 1.988–5T(a)(6)(ii)(F), the legging out rules under § 1.988–5 treat a taxpayer that legs out of a synthetic debt instrument under section 988 as having disposed of any remaining hedges, and those hedges cannot be part of a qualified hedging transaction for any period after the leg-out date.

The Treasury Department and the IRS have determined that achieving greater alignment between the hedge integration regimes under sections 988 and 1275 is beyond the scope of this project and unnecessary to achieve the purpose of the Temporary Regulations. The limited purpose of the Temporary Regulations was to clarify the application of the legging out rules under § 1.988–5 to a particular fact pattern rather than to undertake a more general revision of those rules. When some of the hedge components of a qualified hedging transaction are disposed of on a leg-out date, deeming a disposition of all remaining components is sufficient to achieve a clear reflection of income. Continuing to treat the remaining components as integrated, as under the rule of § 1.1275–6, would represent a departure from the approach taken in the original § 1.988–5 regulations. Nonetheless, the Treasury Department and the IRS will continue to consider whether the hedge integration regimes under sections 988 and 1275 should be modified and brought into closer conformity.

As further support for the recommendation to achieve better alignment between §§ 1.988–5 and 1.1275–6, the comment also suggested that the provision in § 1.988–5T(a)(6)(ii)(F) of the Temporary Regulations, which was also included in the prior final regulations, would be unnecessary if the regulations were modified to conform to § 1.1275–6. Under § 1.988–5T(a)(6)(ii)(F), if a taxpayer legs out of a qualified hedging transaction and realizes a gain with respect to the debt instrument or hedge that is disposed of or otherwise terminated, then the taxpayer is not treated as legging out if during the period beginning 30 days before the leg-out date and ending 30 days after that date the taxpayer enters into another transaction that, taken together with any remaining components of the hedge, hedges at least 50 percent of the remaining currency flow with respect to the qualifying debt instrument that was part of the qualified hedging transaction. Section 1.988–5T(a)(6)(ii)(F) also provides a similar rule where a taxpayer has a qualified hedging transaction comprised of multiple components. In such a case, the taxpayer will not be treated as legging out of the qualified hedging transaction if the taxpayer terminates all or a part of one or more of the components and realizes a net gain with respect to the terminated component, components, or portions thereof, provided that the remaining components of the hedge by themselves hedge at least 50 percent of the remaining currency flow with respect to the qualifying debt instrument that was part of the qualified hedging transaction.

The comment suggests that this provision of the section 988 hedging rules is unnecessarily complex, as well as incomplete because it does not cover situations in which, upon legging out, a taxpayer recognizes a loss on the debt instrument or hedge that is disposed of or otherwise terminated. However, as stated in this preamble, in issuing the Temporary Regulations, the Treasury Department and the IRS only sought to clarify the application of the section 988 hedging rules to a particular fact pattern and did not seek to undertake a more general revision of those rules. Accordingly, the Treasury Department and the IRS have determined that modifications to § 1.988–5T(a)(6)(ii)(F) are beyond the scope of this guidance project. However, the Treasury Department and the IRS will continue to consider whether any modifications to the rule are necessary or appropriate.

Finally, the comment also recommended that, even if the final regulations do not adopt the recommendation to align with the approach taken in § 1.1275–6, the Temporary Regulations should be modified to provide that, when an issuer of a qualifying debt instrument legs out but continues to be the obligor on the qualifying debt instrument, the issuer should be deemed to repurchase and reissue the debt instrument for its then fair market value. The Temporary Regulations instead provide that, in such a case, the debt instrument is “treated as sold for its fair market value.” The comment notes that the sale of a debt instrument has no tax consequences for the issuer of the instrument. The Treasury Department and the IRS agree that this aspect of the Temporary Regulations should be modified and, for the sake of consistency, these final regulations adopt the phrasing “treated as sold or otherwise terminated by the taxpayer for its fair market value,” which is used in § 1.988–5(a)(6)(i)(C) (regarding legging in).

The final regulations also update the dates in two existing examples, to be consistent with the applicability date of the revised legging out rules. Additionally, the final regulations reflect minor wording changes to the Temporary Regulations for purposes of improving clarity. The Treasury Department and the IRS do not intend these changes to be interpreted as substantive changes to the Temporary Regulations.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that these regulations will not have a significant impact on a substantial number of small entities. This certification is based upon the fact that these regulations merely clarify an existing standard and do not impose a collection of information on small entities. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Sheila Ramaswamy, Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

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Adoptions of Amendment to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805* * *

Par. 2. Section 1.988–5 is amended by:

1. Revising paragraph (a)(6)(ii).

2. Adding *Example 11* to paragraph (a)(9)(iv).

3. Revising paragraph (a)(10)(iv).

The revisions and addition read as follows:

§ 1.988–5 Section 988(d) hedging transactions.

(a)* * *

(6) * * *

(ii) *Legging out.* With respect to a qualifying debt instrument and hedge that are properly identified as a qualified hedging transaction, “legging out” of integrated treatment under this paragraph (a) means that the taxpayer disposes of or otherwise terminates all or any portion of the qualifying debt instrument or the hedge before maturity of the qualified hedging transaction. For purposes of the preceding sentence, if the taxpayer changes a material term of the qualifying debt instrument (for example, exercises an option to change the interest rate or index, or the maturity date) or the hedge (for example, changes the interest or exchange rates underlying the hedge, or the expiration date) before maturity of the qualified hedging transaction, the taxpayer will be deemed to have disposed of or otherwise terminated all or any portion of the qualifying debt instrument or the hedge, as applicable. A taxpayer that disposes of or terminates a qualified hedging transaction (that is, disposes of or terminates both the qualifying debt instrument and the hedge in their entirety on the same day) is considered to have disposed of or otherwise terminated the synthetic debt instrument rather than legging out. See paragraph (a)(9)(iv) of this section, *Example 10* for an illustration of this rule. If a taxpayer legs out of integrated treatment, the following rules apply:

(A) The transaction will be treated as a qualified hedging transaction during the time the requirements of this paragraph (a) were satisfied.

(B) If all of the instruments comprising the hedge (each such instrument, a component) are disposed of or otherwise terminated, the qualifying debt instrument is treated as sold or otherwise terminated by the taxpayer for its fair market value on the date the hedge is disposed of or otherwise terminated (the leg-out date), and any gain or loss (including gain or loss resulting from factors other than movements in exchange rates) from the identification date to the leg-out date is realized and recognized on the leg-out date. The spot rate on the leg-out date is used to determine exchange gain or loss on the debt instrument for the period beginning on the leg-out date and ending on the date such instrument matures or is disposed of or otherwise terminated. Proper adjustment must be made to reflect any gain or loss taken into account. The netting rule of § 1.988–2(b)(8) applies. See paragraph (a)(9)(iv) of this section, *Example 4* and *Example 5* for an illustration of this rule.

(C) If a hedge has more than one component (and such components have been properly identified as being part of the qualified hedging transaction) and at least one but not all of the components that comprise the hedge has been disposed of or otherwise terminated, or if part of any component of the hedge has been terminated (whether a hedge consists of a single or multiple components), the date such component (or part thereof) is disposed of or terminated is considered the leg-out date and the qualifying debt instrument is treated as sold or otherwise terminated by the taxpayer for its fair market value in accordance with the rules of paragraph (a)(6)(ii)(B) of this section on such leg-out date. In addition, all of the remaining components (or parts thereof) that have not been disposed of or otherwise terminated are treated as sold by the taxpayer for their fair market value on the leg-out date, and any gain or loss from the identification date to the leg-out date is realized and recognized on the leg-out date. To the extent relevant, the spot rate on the leg-out date is used to determine exchange gain or loss on the remaining components (or parts thereof) for the period beginning on the leg-out date and ending on the date such components (or parts thereof) are disposed of or otherwise terminated. See paragraph (a)(9)(iv) of this section, *Example 11* for an illustration of this rule.

(D) If the qualifying debt instrument is disposed of or otherwise terminated in whole or in part, the date of such disposition or termination is considered the leg-out date. Accordingly, the hedge (including all components making up the hedge in their entirety) that is part of the qualified hedging transaction is treated as sold by the taxpayer for its fair market value on the leg-out date, and any gain or loss from the identification date to the leg-out date is realized and recognized on the leg-out date. To the extent relevant, the spot rate on the leg-out date is used to determine exchange gain or loss on the hedge (including all components thereof) for the period beginning on the leg-out date and ending on the date such hedge is disposed of or otherwise terminated.

(E) Except as provided in paragraph (a)(8)(iii) of this section (regarding identification by the Commissioner), the part of the qualified hedging transaction that has not been disposed of or otherwise terminated (that is, the remaining debt instrument in its entirety even if partially hedged, or the remaining components of the hedge) cannot be part of a qualified hedging transaction for any period after the leg-out date.

(F) If a taxpayer legs out of a qualified hedging transaction and realizes a net gain with respect to the debt instrument that is disposed of or otherwise terminated, then paragraph (a)(6)(ii)(B), (C), and (D) of this section, as appropriate, will not apply if during the period beginning 30 days before the leg-out date and ending 30 days after that date the taxpayer enters into another transaction that, taken together with any remaining components of the hedge, hedges at least 50 percent of the remaining currency flow with respect to the qualifying debt instrument that was part of the qualified hedging transaction or, if appropriate, an equivalent amount under the hedge (or any remaining components thereof) that was part of the qualified hedging transaction. Similarly, in a case in which a hedge has multiple components that are part of a qualified hedging transaction, if the taxpayer legs out of a qualified hedging transaction by terminating one such component or a part of one or more such components and realizes a net gain with respect to the terminated component, components, or portions thereof, then paragraphs (a)(6)(ii)(B), (C), and (D) of this section, as appropriate, will not apply if the remaining components of the hedge (including parts thereof) by themselves hedge at least 50 percent of the remaining currency flow with respect to the qualifying debt instrument that was part of the qualified hedging transaction. See paragraph (a)(9)(iv) of this section, *Example 11* for an illustration of this rule.

* * * * *

(9) * * *

(iv) * * *

Example 11. (i) K is a domestic corporation with the U.S. dollar as its functional currency. On January 1, 2013, K borrows 100 British pounds (£) for two years at a 10% rate of interest payable on December 31 of each year with no principal payment due until maturity on December 31, 2014. Assume that the spot rate on January 1, 2013, is £1=$1. On the same date, K enters into two swap contracts with an unrelated counterparty that economically results in the transformation of the fixed rate £100 borrowing to a floating rate dollar borrowing. The terms of the swaps are as follows:

(A) *Swap #1, Currency swap*. On January 1, 2013, K will exchange £100 for $100.

(*1*) On December 31 of both 2013 and 2014, K will exchange $8 for £10;

(*2*) On December 31, 2014, K will exchange $100 for £100.

(B) *Swap #2, Interest rate swap*. On December 31 of both 2013 and 2014, K will pay LIBOR times a notional principal amount of $100 and will receive 8% times the same $100 notional principal amount.

(ii) Assume that K properly identifies the pound borrowing and the swap contracts as a qualified hedging transaction as provided in paragraph (a)(8)(i) of this section and that the other relevant requirements of paragraph (a) of this section are satisfied.

(iii) On January 1, 2014, the spot exchange rate is £1=$2; the U.S. dollar LIBOR rate of interest is 9%; the market value of K's note in pounds has not changed; and K terminates swap #2. Because interest rates have increased from 8% to 9%, K will incur a loss of ($.92) (the present value of the ($1) difference between the 8% and 9% interest payments discounted at the current interest rate of 9%) with respect to the termination of such swap on January 1, 2014. Pursuant to paragraph (a)(6)(ii)(C) of this section, K must treat swap #1 as having been sold for its fair market value on the leg-out date, which is the date swap #2 is terminated. K must realize and recognize gain of $100.92 (the present value of £110 discounted in pounds to equal £100 x $2 ($200) less the present value of $108 ($99.08)). The loss inherent in the pound borrowing from January 1, 2013 to January 1, 2014 is realized and recognized on January 1, 2014. Such loss is exchange loss in the amount of $100 (the present value of £110 that was to be paid at the end of the year discounted at pound interest rates to equal £100 times the change in exchange rates: (£100 x $1, the spot rate on January 1, 2013) – (£100 x $2, the spot rate on January 1, 2014)). Pursuant to paragraph (a)(6)(ii)(E) of this section, except as provided in paragraph (a)(8)(iii) of this section (regarding identification by the Commissioner), the pound borrowing and currency swap cannot be part of a qualified hedging transaction for any period after the leg-out date.

(iv) Assume the facts are the same as in paragraph (iii) of this *Example* except that on January 1, 2014, the U.S. dollar LIBOR rate of interest is 7% rather than 9%. When K terminates swap #2, K will realize gain of $0.93 (the present value of the ($1) difference between the 8% and 7% interest payments discounted at the current interest rate of 7%) received with respect to the termination on January 1, 2014. Fifty percent or more of the remaining pound cash flow of the pound borrowing remains hedged after the termination of swap #2. Accordingly, under paragraph (a)(6)(ii)(F) of this section, paragraphs (a)(6)(ii)(B) and (C) of this section do not apply, and the gain on swap #1 and the loss on the qualifying debt instrument are not taken into account. Thus, K will

include in income $0.93 realized from the termination of swap #2.

(10) * * *

(iv) *Effective/applicability dates for legging in and legging out rules*. (A) The rules of paragraph (a)(6)(i) of this section are effective for qualified hedging transactions that are legged into after March 17, 1992.

(B) The rules of paragraph (a)(6)(ii) and *Example 11* of paragraph (a)(9)(iv) of this section apply to leg-outs that occur on or after September 6, 2012.

* * * * *

§ 1.988–5 [Amended]

Par. 3. For each section listed in the table, remove the language in the "Remove" column and add in its place the language in the "Add" column as set forth below:

Section	*Remove*	*Add*
§ 1.988–5(a)(9)(iv), Example 4, paragraph (i), second, third and fourth sentences	January 1, 1990	January 1, 2013
§ 1.988–5(a)(9)(iv), Example 4, paragraph (i), table	December 31, 1990	December 31, 2013
§ 1.988–5(a)(9)(iv), Example 4, paragraph (i), table	December 31, 1991	December 31, 2014
§ 1.988–5(a)(9)(iv), Example 4, paragraph (i), table	December 31, 1992	December 31, 2015
§ 1.988–5(a)(9)(iv), Example 4, paragraph (iii)(B)	1990	2013
§ 1.988–5(a)(9)(iv), Example 4, paragraph (iii)(B)	1991	2014
§ 1.988–5(a)(9)(iv), Example 4, paragraph (iii)(B)	1992	2015
§ 1.988–5(a)(9)(iv), Example 4, paragraph (iii)(D), second sentence	1992	2015

Section	Remove	Add
§ 1.988–5(a)(9)(iv), Example 4, paragraph (iv), first, second, fourth, fifth, and sixth sentences	January 1, 1991	January 1, 2014
§ 1.988–5(a)(9)(iv), Example 4, paragraph (iv), first, fourth, and fifth sentences	January 1, 1990	January 1, 2013
§ 1.988–5(a)(9)(iv), Example 4, paragraph (iv), third sentence	1990	2013
§ 1.988–5(a)(9)(iv), Example 4, paragraph (iv), sixth and seventh sentences	December 31, 1992	December 31, 2015
§ 1.988–5(a)(9)(iv), Example 5, paragraph (i), second, fourth, and fifth sentences	January 1, 1990	January 1, 2013
§ 1.988–5(a)(9)(iv), Example 5, paragraph (i), table	December 31, 1990	December 31, 2013
§ 1.988–5(a)(9)(iv), Example 5, paragraph (i), table	December 31, 1991	December 31, 2014
§ 1.988–5(a)(9)(iv), Example 5, paragraph (i), table	December 31, 1992	December 31, 2015
§ 1.988–5(a)(9)(iv), Example 5, paragraph (ii), second and third sentences	January 1, 1991	January 1, 2014
§ 1.988–5(a)(9)(iv), Example 5, paragraph (ii), second sentence	January 1, 1990	January 1, 2013
§ 1.988–5(a)(9)(iv), Example 5, paragraph (ii), third sentence	December 31, 1991	December 31, 2014
§ 1.988–5(a)(9)(iv), Example 5, paragraph (ii), third sentence	December 31, 1992	December 31, 2015
§ 1.988–5(a)(9)(iv), Example 5, paragraph (ii), third sentence	1991	2014
§ 1.988–5(a)(9)(iv), Example 5, paragraph (ii), third sentence	1992	2015
§ 1.988–5(a)(9)(iv), Example 5, paragraph (iii), second sentence	January 1, 1990	January 1, 2013
§ 1.988–5(a)(9)(iv), Example 5, paragraph (iii), second sentence	January 1, 1991	January 1, 2014
§ 1.988–5(a)(9)(iv), Example 5, paragraph (iii)(B)	1990	2013
§ 1.988–5(a)(9)(iv), Example 5, paragraph (iii)(B)	1991	2014
§ 1.988–5(a)(9)(iv), Example 5, paragraph (iii)(B)	1992	2015
§ 1.988–5(a)(9)(iv), Example 5, paragraph (iii)(C), first sentence	1990	2013
§ 1.988–5(a)(9)(iv), Example 5, paragraph (iii)(C), first sentence	1991	2014
§ 1.988–5(a)(9)(iv), Example 5, paragraph (iii)(C), first sentence	1992	2015
§ 1.988–5(a)(9)(iv), Example 5, paragraph (iii)(D), second sentence	1990	2013
§ 1.988–5(a)(9)(iv), Example 5, paragraph (iv), first, second, third, and sixth sentences	January 1, 1991	January 1, 2014
§ 1.988–5(a)(9)(iv), Example 5, paragraph (iv), fourth sentence	1990	2013

§ 1.988–5T [Removed]

Par. 4. Section 1.988–5T is removed.

John Dalrymple, *Deputy Commissioner for Services and Enforcement.*

Approved: August 25, 2015.

Mark J. Mazur, *Assistant Secretary of the Treasury (Tax Policy).*

Note

(Filed by the Office of the Federal Register on September 3, 2015, 4:15 p.m., and published in the issue of the Federal Register for September 8, 2015, 80 F.R. 53732)

Prev Up Next
Home

More Internal Revenue Bulletins

Internal Revenue Bulletin: 2017-2

January 9, 2017

Highlights of This Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

REG–128276–12 REG–128276–12

The temporary and proposed regulations contain rules relating to the recognition and deferral of foreign currency gain or loss under section 987 with respect to a QBU in connection with certain QBU terminations and certain other transactions involving partnerships. The temporary and proposed regulations also provide for (i) an annual deemed termination election for a section 987 QBU; (ii) an elective method, available to taxpayers that make the annual deemed termination election, for translating all items of income or loss with respect to a section 987 QBU at the yearly average exchange rate; (iii) rules regarding the treatment of section 988 transactions of a section 987 QBU; (iv) rules regarding QBUs with the U.S. dollar as their functional currency; (v) rules regarding combinations and separations of section 987 QBUs; (vi) rules regarding the translation of income used to pay creditable foreign income taxes; (vii) rules regarding the allocation of assets and liabilities of certain partnerships for purposes of section 987; and (viii) rules under section 988 requiring the deferral of certain section 988 loss that arises with respect to related-party loans.

Rev. Rul. 2017–02 Rev. Rul. 2017–02

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, 7872, and other sections of the Code, tables set forth the rates for January 2017.

Notice 2017–03 Notice 2017–03

This notice provides the maximum vehicle values for use with the special valuation rules under regulation section 1.61–21(d) and (e) for 2017. These values are adjusted for inflation and must be adjusted annually by reference to

the Consumer Price Index.

T.D. 9794 T.D. 9794

The final regulations provide guidance under section 987 regarding the determination of the taxable income or loss of a taxpayer with respect to a qualified business unit (QBU) subject to section 987, as well as the timing, amount, character, and source of any section 987 gain or loss.

T.D. 9795 T.D. 9795

The temporary and proposed regulations contain rules relating to the recognition and deferral of foreign currency gain or loss under section 987 with respect to a QBU in connection with certain QBU terminations and certain other transactions involving partnerships. The temporary and proposed regulations also provide for an annual deemed termination election for a section 987 QBU; an elective method, available to taxpayers that make the annual deemed termination election, for translating all items of income or loss with respect to a section 987 QBU at the yearly average exchange rate; rules regarding the treatment of section 988 transactions of a section 987 QBU; rules regarding QBUs with the U.S. dollar as their functional currency; rules regarding combinations and separations of section 987 QBUs; rules regarding the translation of income used to pay creditable foreign income taxes; rules regarding the allocation of assets and liabilities of certain partnerships for purposes of section 987; and rules under section 988 requiring the deferral of certain section 988 loss that arises with respect to related-party loans.

T.D. 9801 T.D. 9801

The final regulations provide a revised definition of issue price for purposes of the arbitrage restrictions under section 148 that apply to tax-exempt bonds under section 103, tax credit bonds under section 54A, and direct pay bonds under section 6431.

EMPLOYEE PLANS

Notice 2017–01 Notice 2017–01

This notice provides guidance on section 7528(b)(2) of the Code, relating to an exemption from the requirement to pay a user fee for certain requests to the IRS for determination letters with respect to the qualified status of pension, profit-sharing, stock bonus, annuity, and employee stock ownership plans maintained by small employers. This notice is being issued as a result of changes made to the determination letter program and remedial amendment period rules set forth in Rev. Proc. 2016–37, 2016–29 I.R.B. 136.

EXCISE TAX

REG–134438–15 REG–134438–15

These proposed regulations would modify the current definition of "net premiums written" for purposes of the fee imposed by section 9010 of the Affordable Care Act.

ADMINISTRATIVE

REG–133353–16 REG–133353–16

This document contains proposed regulations that authorize the disclosure of certain items of return information to the Bureau of the Census in conformance with section 6103(j)(1) of the Internal Revenue Code.

Notice 2017–03 Notice 2017–03

This notice provides the maximum vehicle values for use with the special valuation rules under regulation section 1.61–21(d) and (e) for 2017. These values are adjusted for inflation and must be adjusted annually by reference to the Consumer Price Index.

T.D. 9802 T.D. 9802

This document contains temporary regulations that authorize the disclosure of certain items of return information to the Bureau of the Census in conformance with section 6103(j)(1) of the Internal Revenue Code.

Preface

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code. This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation. This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous. To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest. This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

T.D. 9794

Income and Currency Gain or Loss with Respect to a Section 987 QBU

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 602

AGENCY:

Internal Revenue Service (IRS), Treasury.

ACTION:

Final Regulations.

SUMMARY:

This document contains final regulations that provide guidance under section 987 of the Internal Revenue Code (Code) regarding the determination of the taxable income or loss of a taxpayer with respect to a qualified business unit (QBU) subject to section 987, as well as the timing, amount, character, and source of any section 987 gain or loss. Taxpayers affected by these regulations are corporations and individuals that own QBUs subject to section 987. In addition, published elsewhere in this issue of the **Bulletin,** temporary and proposed regulations (the temporary regulations) are being issued under section 987 to address aspects of the application of section 987 not addressed in these final regulations.

DATES:

Effective date: These regulations are effective on December 7, 2016.

Applicability dates: For dates of applicability, see § 1.987–11.

FOR FURTHER INFORMATION CONTACT: Sheila Ramaswamy at (202) 317-6938 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-2265. Responses to this collection of information are mandatory.

The collection of information in these final regulations is in §§ 1.987–1(b)(2)(ii), 1.987–1(c)(1)(ii), 1.987–1(c)(1)(iii), 1.987–1(g)(3)(i)(A), 1.987–1(g)(3)(i)(B), 1.987–1(g)(3)(i)(C), 1.987–1(g)(3)(i)(D), 1.987–3(c)(2)(iv)(B), 1.987–9, and 1.987–10(e). This collection of information is required to establish the taxable income or loss of a taxpayer with respect to a QBU subject to section 987, as well as the timing, amount, character, and source of any section 987 gain or loss and the exchange rates used for foreign currency translation purposes.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books and records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains final regulations relating to the determination of the taxable income or loss of a taxpayer with respect to a QBU subject to section 987 of the Code, as well as the timing, amount, character, and source of any section 987 gain or loss. The final regulations also amend existing regulations under sections 861, 985, 988, and 989.

On September 6, 2006, the Treasury Department and the IRS published a notice of proposed rulemaking (REG–208270–86, 71 FR 52876) that proposed new regulations under section 987 (the 2006 proposed regulations) and withdrew proposed regulations under section 987 published on September 25, 1991 (INTL–965–86, 56 FR 48457) (the 1991 proposed regulations). The Treasury Department and the IRS received many written comments in response to the 2006 proposed regulations. After consideration of all the comments, the 2006 proposed regulations, as revised by this Treasury decision, are adopted as final regulations. Temporary regulations (TD 9795) and proposed regulations (REG–128276–12) under section 987 are being published contemporaneously with these final regulations.

Summary of Comments and Explanation of Revisions

I. *Background*

Section 987 generally provides that, when a taxpayer owns one or more QBUs with a functional currency other than the U.S. dollar and such functional currency is different than that of the taxpayer, the taxable income or loss of the taxpayer with respect to each QBU is determined by computing the taxable income or loss of each QBU separately in its functional currency and translating such income or loss at the appropriate exchange rate. Section 987 further requires the taxpayer to make “proper adjustments” (as prescribed by the Secretary) for transfers of property between QBUs having different functional currencies, including by treating post-1986 remittances from each such QBU as made on a pro rata basis out of post-1986 accumulated earnings and by treating section 987 gain or loss as ordinary income or loss and sourcing such gain or loss by reference to the source of the income giving rise to post-1986 accumulated earnings.[1] Section 989(b)(4) provides that, “[e]xcept as provided in regulations,” the appropriate exchange rate with respect to a QBU means “the average exchange rate for the taxable year” of the QBU. Additionally, section 989(c)(5) directs the Secretary to “prescribe such regulations as may be

necessary or appropriate to carry out the purposes of [subpart J], including regulations . . . providing for the appropriate treatment of related party transactions (including transactions between qualified business units of the same taxpayer) . . . ."

A. *1991 proposed regulations*

The 1991 proposed regulations generally provided that the net income of a QBU with a functional currency other than that of the taxpayer was determined annually. Such determination was based on the profit and loss appearing on the QBU's books and records, adjusted to conform to U.S. tax principles, and translated into the functional currency of the taxpayer using the weighted average exchange rate for the taxable year. The 1991 proposed regulations also provided for the recognition of exchange gain or loss upon a remittance from the QBU's equity pool. In general, the equity pool consisted of the contributed capital and earnings of the QBU, reduced by remittances, determined in the QBU's functional currency. The 1991 proposed regulations also provided for a basis pool, which consisted of the basis of the capital and earnings in the equity pool, expressed in the functional currency of the taxpayer. The portion of the basis pool that was attributable to a remittance generally was determined according to the following formula:

Amount remitted in the *QBU's functional currency* Equity pool in the QBU's functional currency	x Basis pool in the taxpayer's functional currency

Under the 1991 proposed regulations, section 987 gain or loss was the difference between the value of the remittance from the QBU, translated into the taxpayer's functional currency at the spot rate on the date of the remittance, and the basis associated with the remittance.

One important consequence of the equity pool paradigm was that all branch equity gave rise to exchange gain or loss, regardless of whether the equity was invested in assets that actually exposed the QBU's owner to currency fluctuations. For example, both cash denominated in the QBU's functional currency and mobile equipment equally gave rise to exchange gain or loss. As a result, under the 1991 proposed regulations, exchange rate changes that, at most, had only an uncertain and remote effect on the economic results experienced by the owner of a QBU gave rise to substantial exchange gains and losses that taxpayers selectively could recognize by strategically timing remittances or causing a termination of the QBU. Given these distortions, the Treasury Department and the IRS withdrew the 1991 proposed regulations and proposed new regulations on September 6, 2006.

B. *2006 proposed regulations*

The 2006 proposed regulations adopted a different paradigm referred to as the foreign exchange exposure pool (FEEP) method. In general, the FEEP method provides that, as under the 1991 proposed regulations, the income of a QBU that is subject to section 987 (a section 987 QBU) is determined by reference to the items of income, gain, deduction, and loss booked to the section 987 QBU in its functional currency, adjusted to reflect U.S. tax principles. Items of income and deduction generally are translated, consistent with the 1991 proposed regulations, into the functional currency of the section 987 QBU's owner at the average exchange rate for the year. However, the basis of certain "historic assets" and the deductions for depreciation, depletion, and amortization of such assets are translated at the historic rates for such assets. Translating these items at historic rates represents a major difference from the 1991 proposed regulations and prevents the imputation of foreign currency gains or losses to such assets. Additionally, the 2006 proposed regulations required the adjusted basis and amount realized with respect to marked assets to be translated using a spot rate, which for assets acquired in a prior taxable year would be the spot rate for the closing balance sheet of the prior taxable year.

Consistent with the 1991 proposed regulations, the FEEP method uses a balance sheet approach to determine exchange gain or loss, which is not recognized until the section 987 QBU makes a remittance. Under the FEEP method, exchange gain or loss with respect to "marked items" is determined annually but is pooled and deferred until a remittance is made. A marked item generally is defined under the 2006 proposed regulations as an asset (marked asset) or liability (marked liability) that would generate section 988 gain or loss if such asset or liability were held or entered into directly by the owner of the section 987 QBU. The balance sheet approach, together with the use of historic rates for historic items (generally defined as an asset or liability that is not a marked item), allows taxpayers and the IRS to distinguish between items whose value is highly responsive to changes in the functional currency of the owner and items for which exchange rate changes have no effect on value, or only an uncertain or remote effect that is more appropriately recognized upon a realization event with respect to the item.

The 2006 proposed regulations define a remittance as a net transfer of amounts from a section 987 QBU to its owner during a taxable year, determined in the owner's functional currency. When a section 987 QBU makes a remittance, a portion of the pooled exchange gain or loss is recognized. In general, the amount taken into account equals the section 987 QBU's net unrecognized exchange gain or loss multiplied by the owner's remittance proportion. The owner's remittance proportion generally equals the amount of the remittance divided by the aggregate basis of the section 987 QBU's gross assets reflected on its year-end balance sheet, determined in the owner's functional currency, without reduction for the remittance.

II. *Summary of Comments and Changes*

Many comments were received in response to the 2006 proposed regulations. This Part II discusses those comments and the changes made in response to them. Certain comments received in response to the 2006 proposed regulations are addressed in the temporary regulations and are discussed in the preamble to the temporary regulations rather than in this preamble.

A. *General comments regarding the FEEP method, including regarding administrability*

A number of comments suggested that the FEEP method, in particular §§ 1.987–3 and –4 of the 2006 proposed regulations, would be difficult to administer. Some of those comments expressed a preference to more closely align regulations under section 987 with the financial accounting rules under Accounting Standards Codification, Foreign Currency Matters, section 830 (ASC 830).[2]

ASC 830 adopts a functional currency paradigm in which assets, liabilities, and operations of a foreign entity are measured using the entity's functional currency[3] and then translated into the reporting currency (generally, the U.S. dollar) of a U.S. enterprise using a current exchange rate.[4] Thus, revenues, expenses, gains, and losses of the foreign entity, translated into U.S. dollars using a weighted average exchange rate for the reporting period, are included in the consolidated profit and loss statement of the U.S. enterprise,[5] and the assets and liabilities of the foreign entity, translated into U.S. dollars using the spot rate on the balance sheet date, are included in the consolidated balance sheet of the U.S. enterprise.[6] Foreign currency "translation" gain or loss of a foreign entity with a functional currency other than the U.S. dollar is determined with respect to all assets and liabilities on the entity's balance sheet at the end of a reporting period and reported in the cumulative translation adjustment (CTA) account. The CTA account is a sub-account in the equity section of the balance sheet.[7] It is not reflected in profit or loss until the occurrence of a sale or a complete or substantially complete liquidation of the entity.[8] ASC 830[9] explains the rationale for accounting for translation gain or loss in equity and not income:

> Translation adjustments are solely a result of the translation process and have no direct effect on reporting currency cash flows. Exchange rate changes have an indirect effect on the net investment that may be realized upon sale or liquidation, but that effect is related to the net investment and not to the operations of the investee. Prior to sale or liquidation, that effect is so uncertain and remote as to require that translation adjustments arising currently should not be reported as part of operating results.

The treatment of translation gains and losses can be contrasted with the financial accounting treatment of transactions denominated in a currency other than the entity's functional currency. Changes in exchange rates between the functional currency of the foreign entity and the currency in which such transactions are denominated give rise to changes in expected cash flows in the functional currency, resulting in "transaction" gains or losses. The financial accounting rules require the inclusion of transaction gains and losses in net income for the period in which the exchange rate changes occur.[10] The category of foreign currency transactions that give rise to transaction gains and losses under generally accepted accounting principles overlaps considerably with the definition of a section 988 transaction for tax purposes.

Some comments suggested that, in enacting section 987, Congress intended to substantially adopt the financial accounting rules for foreign currency translation for tax purposes. The Treasury Department and the IRS do not find support for this position in the legislative history to section 987 and, to the contrary, find the position belied by the significant discontinuities between section 987 and the financial accounting rules, particularly regarding the recognition of foreign currency gains and losses. Under Financial Accounting Standard No. 52 (FAS 52), translation gain or loss is deferred in an equity account until a sale or liquidation of the foreign entity, at which point the economic effects of the aggregate translation gain or loss can be measured against a real economic event. The "equity pool" paradigm of the 1991 proposed regulations determined the amount of section 987 gain or loss in a manner that was similar to the determination of translation gain or loss under FAS 52 by imputing foreign currency gain or loss to all assets and liabilities on the balance sheet. In contrast with the accounting rules under FAS 52, however, the translation gain or loss was not sequestered in an equity account but rather was included in income upon a remittance as required by the section 987 statute, making the consequences of imputing foreign currency gain or loss to all assets and liabilities substantially greater.

As expressed in the preamble to the 2006 proposed regulations, the administrative convenience achieved by generally adopting the FAS 52 computational methodology in the 1991 proposed regulations gave rise to many cases in which the section 987 gain or loss taken into account on a remittance deviated substantially from the economic results experienced by the QBU. For example, currency loss was imputed with respect to assets (such as a commercial building or an oil rig) for which, due to the mobility of investment capital or the assets themselves, exchange rate fluctuations would have, at most, only a remote and uncertain effect on asset value. Moreover, because remittances could be funded from other assets, such loss could be recognized without regard to any realization event with respect to the assets that gave rise to the speculative or noneconomic section 987 loss.

Given the inappropriate economic and timing results attributable to adopting the FAS 52 translation methodology in the 1991 proposed regulations and the significant differences between the purposes of the FAS 52 computation of CTA

and the computation of unrecognized section 987 gain or loss, the Treasury Department and the IRS remain of the view that the FAS 52 model is not appropriate for tax purposes. Similarly, the Treasury Department and the IRS have determined that an approach based on consistency with FAS 52 computations modified to address abuses, as suggested in some comments, is inappropriate because such a system would impute foreign currency gain or loss to all assets and liabilities on the balance sheet and generally allow for the recognition of such gains and losses based on remittances without regard to the owner's actual economic exposure to the QBU's functional currency. Rather, the Treasury Department and the IRS have determined that an approach premised on consistency with section 988, modified to take into account administrability and policy considerations unique to section 987, will carry out the purposes of section 987 most appropriately.

Other comments recommended a hybrid approach that would combine the methodology of the 1991 proposed regulations for computing a section 987 QBU's net income with the methodology of the 2006 proposed regulations for computing section 987 gain or loss. Under the proposed hybrid approach, section 987 gain or loss generally would be determined under the method of the 2006 proposed regulations, but taxable income or loss would be translated into the owner's functional currency at the yearly average exchange rate without any adjustments. A consequence of this hybrid approach is that a different exchange rate would be used to translate recovered basis with respect to historic assets in determining taxable income or loss than would be used to translate such basis to determine section 987 gain or loss. These comments generally favored the FEEP method for determining section 987 gain or loss because it avoids imputing section 987 gain or loss to all assets and liabilities on the balance sheet, as under the 1991 proposed regulations, but asserted that determining taxable income or loss in the functional currency of the section 987 QBU and translating that amount into the owner's functional currency at the yearly average exchange rate without any adjustments is more administrable and more consistent with sections 987(1) and (2) and the legislative history of section 987.

The Treasury Department and the IRS have concluded that the proposed hybrid approach would not achieve the goal of ensuring remittances trigger only "exchange gain or loss inherent in accumulated earnings or branch capital," as contemplated by Congress, and inappropriately would cause offsetting exchange rate effects to be reflected in section 987 taxable income or loss and in the FEEP. (H.R. Conf. Rep. No. 99–841, at 675 (1986)). Although a hybrid approach would simplify the calculation of section 987 taxable income or loss, the simplification would cause basis recovery deductions with respect to depreciable and amortizable assets that are included in section 987 taxable income or loss to reflect exchange rate fluctuations with respect to the asset (for which exchange rate fluctuations may have, at most, only a remote and uncertain effect on value). If the asset is retained on the closing balance sheet, the FEEP would reflect equal and offsetting exchange rate fluctuations with respect to the asset, to the extent of any accumulated depreciation or

amortization that was included in taxable income and translated at current exchange rates. This is because, in determining section 987 gain or loss under § 1.987–4 of the 2006 proposed regulations, section 987 taxable income or loss is subtracted from the change in the owner functional currency net value (OFCNV) of the section 987 QBU, which is determined using historic exchange rates for historic items. Accordingly, the distortion in the determination of section 987 taxable income or loss with respect to historic assets would cause an offsetting distortion in the FEEP.

An example illustrates the equal and offsetting exchange rate effects that can arise with respect to a historic asset under the hybrid approach. Consider the situation of a section 987 QBU (euro QBU) that has the euro as its functional currency and that has an owner that has the dollar as its functional currency. If euro QBU acquires depreciable equipment for €100 on the last day of year 1, when the historic exchange rate is €1 = $1, and takes into account €10 of depreciation with respect to the equipment in year 2, when the yearly average exchange rate is €1 = $1.50, the €10 of depreciation would be translated at the year 2 average exchange rate into $15 under the hybrid approach rather than $10, as would happen if depreciation were translated at the €1 = $1 historic rate under the 2006 proposed regulations. As a result, section 987 taxable income of euro QBU is $5 lower under the hybrid approach than it would be under the 2006 proposed regulations.

In this example, the FEEP, in turn, would be higher by $5 under the hybrid approach than it would be under the 2006 proposed regulations. This is because, in determining the change to the FEEP for a taxable year, section 987 taxable income is subtracted from the change in OFCNV of euro QBU, which is computed by translating the adjusted basis of historic assets using the historic exchange rate for each asset. For euro QBU, solely with reference to the depreciable equipment, year 2 depreciation causes a $10 reduction in OFCNV, because in computing the change in OFCNV, the €10 change in equipment basis during year 2 is translated at the €1 = $1 historic rate (year 2 closing balance sheet of $90 adjusted basis, less year 1 closing balance sheet of $100 adjusted basis). In order to compute the change to the FEEP for year 2 with respect to the depreciable equipment, section 987 taxable income with respect to the equipment is subtracted from the $10 reduction in OFCNV. Thus, the net effect of the depreciation in the FEEP is to increase section 987 gain reflected in the FEEP by $5 (negative $10 change in OFCNV, less $15 depreciation deduction).

Considering all of these effects together, under the hybrid approach, the appreciation of the euro decreases section 987 taxable income by $5 and increases section 987 gain reflected in the FEEP by $5. In other words, the FEEP reflects currency gain or loss with respect to the depreciable asset that is offset by an amount that was included in section 987 taxable income. This effect on the FEEP persists even after the asset is sold.

The Treasury Department and the IRS have determined that the offsetting effects in section 987 taxable income or loss and in the FEEP under the hybrid approach raise concerns similar to the concerns that Congress addressed, albeit

in a different context, in enacting section 1092. In particular, section 1092 reflects a policy concern regarding inconsistent timing of recognition of gains and losses from offsetting positions. Under the hybrid approach, the exchange rate effect with respect to historic assets would be reflected in section 987 taxable income or loss to the extent of any cost recovery deductions with respect to those assets, but equal and offsetting amounts would be reflected in the FEEP and would not be recognized until there are remittances. Thus, offsetting effects arising from a single asset would be taken into account at different times. Accordingly, the Treasury Department and the IRS have determined that it would be inappropriate for regulations under section 987 to permit distortions to section 987 taxable income or loss, for the sake of enhancing administrability, that have the effect of causing offsetting amounts of gain or loss to be reflected in the FEEP with respect to the same asset, where the latter amounts would be recognized only upon voluntary remittances from the QBU. Rather, consistent with the discussion in the preamble to the 2006 proposed regulations, the Treasury Department and the IRS have determined that, in order to carry out the purposes of section 987(3) as indicated by the legislative history, as well as sections 987(1) and (2), and taking into account the authority granted in sections 989(b) and (c), it is appropriate to account for recovered basis for historic assets at the relevant historic rate in determining taxable income or loss of a section 987 QBU. This result could be accomplished by translating recovered basis at the historic rate in the first instance or by translating taxable income or loss determined in the section 987 QBU's functional currency at the yearly average exchange rate and adjusting that amount to properly account for recovered basis, as under the simplified inventory method described in Part II.A.3 of this preamble.

Nonetheless, the Treasury Department and the IRS acknowledge the observations about the complexity and administrability of the 2006 proposed regulations that underlie the recommendation of the hybrid approach. The concerns about offsetting amounts recognized at different times under the hybrid approach would not arise for taxpayers that make the deemed annual termination election set forth in § 1.987–8T(d) of the temporary regulations. Accordingly, as described in the preamble to the temporary regulations, a taxpayer that makes the deemed annual termination election may also elect under § 1.987–3T(d) to apply the hybrid approach. Additionally, the Treasury Department and the IRS have made several changes in these final regulations in response to comments expressing concern about the complexity and administrability of the 2006 proposed regulations.

In addition to the comments recommending a hybrid approach under which taxable income would be translated at a single exchange rate without any adjustments, other comments expressed more particular concerns regarding the complexity and administrability of the FEEP paradigm specifically with respect to inventory and certain other high-volume, low-value assets. Comments suggested that treating items that turn over quickly, such as inventory, or that have low value as marked items would facilitate administration and compliance while introducing little distortion into the FEEP

calculation. The Treasury Department and the IRS do not agree with these specific recommendations to expand the scope of marked assets, because even assets that turn over quickly or have low-value individually could inappropriately give rise to significant amounts of section 987 gain or loss in the aggregate over time. The Treasury Department and the IRS do, however, acknowledge the general points about complexity and administrability reflected in these suggestions, which are similar to the concerns expressed in the comments recommending the hybrid approach.

In order to reduce complexity and improve administrability, the final regulations modify the 2006 proposed regulations in several significant ways, including by permitting more items to be treated as section 987 marked items, simplifying the treatment of marked items so that net income attributable to such items is translated at the average exchange rate, and simplifying the adjustments that are required to translate basis recovery for historic items at the historic rate. These changes balance the administrability benefits of simplifying the final regulations and bringing them into closer conformity with financial accounting rules against the need to minimize the distortions that would result from permitting taxpayers to include uncertain and remote foreign currency gains and losses in taxable income. In particular, the final regulations allow taxpayers to (a) use the yearly average exchange rate as the historic rate, (b) treat prepaid expenses and liabilities for advance payments of unearned income as section 987 marked items, (c) apply a simplified method with respect to inventory, and (d) translate both basis recovery and amount realized with respect to marked assets at the yearly average exchange rate. Additionally, as described in the preamble to the temporary regulations, the temporary regulations treat certain section 988 transactions as marked items and permit taxpayers to elect to more closely conform the treatment of certain section 988 transactions entered into by a section 987 QBU with their treatment for financial accounting purposes.

1. Yearly Average Exchange Rate as the Historic Rate

Under §§ 1.987–1(c)(3)(i) and 1.987–2(d) of the 2006 proposed regulations, the historic rate used to translate the basis of historic assets was the spot rate on the date on which the asset was transferred to, or otherwise acquired by, a section 987 QBU. Thus, when assets were acquired by a section 987 QBU on multiple days during a single taxable year, the 2006 proposed regulations required taxpayers to track multiple historic spot rates. A comment observed that taxpayer systems often only identify the date an asset is placed in service and recommended that taxpayers be permitted to use a yearly average exchange rate in lieu of a spot rate in translating historic items.

The Treasury Department and the IRS agree that using the yearly average exchange rate rather than a spot rate to translate historic items would reduce complexity and improve administrability without introducing significant distortions into the determination of section 987 taxable income or loss or section 987 gain or loss. Accordingly, § 1.987–1(c)(3)(i) generally provides that

the historic rate is the yearly average exchange rate for the taxable year when a historic asset is acquired, or a historic liability is incurred, by a section 987 QBU. Taxpayers that prefer to use the spot rate as the historic rate, as under the 2006 proposed regulations, may so elect under § 1.987–1(c)(1)(iii). A taxpayer that makes this election is deemed to also make the historic inventory election under § 1.987–3(c)(2)(iv)(B) that is described in Part II.A.3 of this preamble.

In addition, to further improve administrability, § 1.987–1(c)(3)(iii) permits a section 987 QBU that acquires depreciable or amortizable property in one year and places the asset in service in another year to determine the historic rate for the property based on the date the property is placed in service rather than the year the property was acquired, provided that this convention is consistently applied for all such property attributable to that section 987 QBU.

2. Prepaid Expenses and Liabilities Treated as Section 987 Marked Items

Comments suggested that prepaid expenses and liabilities for advance payments of unearned income should be treated as section 987 marked items because they typically have a short duration and often concern small amounts. The Treasury Department and the IRS have determined that treating these items as marked items generally would promote administrability without introducing significant distortions in the determination of section 987 gain or loss. Accordingly, the definition of marked item under § 1.987–1(d) includes prepaid expenses and liabilities for an advance payment of unearned income where such items have an original term of one year or less.

3. Cost of Goods Sold/Inventory

Under the 2006 proposed regulations, inventory was treated as a historic item. As a result, to determine section 987 taxable income or loss with respect to a section 987 QBU under proposed § 1.987–3, cost of goods sold (COGS) had to be translated at a historic spot rate that corresponded to the date the liquidated inventory was acquired or manufactured. A historic spot rate also had to be used to determine the OFCNV of the QBU under proposed § 1.987–4 with respect to inventory that was reflected on the section 987 QBU's year-end balance sheet. For these purposes, the cost basis of inventory purchased for resale generally would have been translated into the owner's functional currency at the spot rate on the date of purchase. With respect to inventory that was manufactured by the section 987 QBU, it would have been necessary to translate individually the various components of COGS at the appropriate historic spot rate for each cost component, resulting in an effective historic rate for manufactured inventory that was a blend of the historic rates applicable to such components. That is, labor, materials and other inventoriable costs would have been translated at the spot rate on the date the cost was incurred or, in the case of depreciation, the date the relevant depreciable asset was acquired. Comments suggested that translating inventoriable costs at their historic spot rates presented significant administrative difficulties. In addition to the comments requesting that certain high volume property be treated as a marked

asset, one comment requested that a simplified method be provided to deal with the administrative difficulties in applying the 2006 proposed regulations to inventory.

In response to comments, these final regulations simplify the translation of COGS and ending inventory in two significant ways. First, the use under § 1.987–1(c)(3) of the yearly average exchange rate rather than a spot rate as the historic rate will significantly simplify the translation of COGS and ending inventory. This change makes it possible to translate all inventory purchased in a given year, and all costs incurred in the production of inventory in a given year (other than depreciation, which is always translated at the historic rate for the year the depreciated property was acquired or placed in service, regardless of whether it is an inventoriable cost), using a single exchange rate. Second, § 1.987–3(c)(2)(iv)(A) prescribes a simplified inventory method under which (i) COGS is translated into the functional currency of the section 987 QBU's owner at the yearly average exchange rate for the current taxable year with a requirement to make only two discrete adjustments to the translated COGS amount, and (ii) a simplified historic rate is used for purposes of determining the OFCNV under Reg. § 1.987–4 for inventory to which the simplified inventory method applies. A taxpayer that prefers the inventory method under the 2006 proposed regulations can elect under § 1.987–3(c)(2)(iv)(B) to translate inventoriable costs that are included in COGS or ending inventory at the historic rate for each such cost and, if they wish, can further elect under § 1.987–1(c)(1)(iii) to use the spot rate as the historic rate.

a. Translation of COGS under the simplified inventory method

Under the simplified inventory method, a section 987 QBU determines COGS in its functional currency and translates that amount at the yearly average exchange rate for the taxable year rather than translating each inventoriable cost at the appropriate historic rate. Taxpayers applying the simplified inventory method must make two adjustments to COGS described in § 1.987–3(c)(3). These adjustments mitigate the consequences of translating COGS at the yearly average exchange rate, as if inventory were a marked asset, rather than translating the inventoriable costs reflected in inventory sold during the taxable year at the appropriate historic rates, as under the 2006 proposed regulations. In particular, the adjustments generally prevent inventory from giving rise to section 987 gain or loss reflected in the FEEP. The adjustments also cause section 987 taxable income or loss to correspond over time to the section 987 taxable income or loss that would have resulted if inventoriable costs were translated at historic rates.

The first adjustment requires the translated COGS amount to be adjusted to reverse the effect of translating (as part of the translation of COGS) cost recovery deductions treated as inventoriable costs at the current yearly average exchange rate rather than at the appropriate historic rates. For a particular cost recovery deduction, this adjustment is calculated as the portion of the deduction treated as an inventoriable cost, computed in the functional

currency of the QBU, multiplied by the amount (whether positive or negative) that is determined by subtracting the yearly average exchange rate at which COGS was translated from the historic rate applicable to the property whose cost is being recovered. For example, in a period in which the functional currency of a section 987 QBU has strengthened against its owner's functional currency, the adjustment would reduce the amount of COGS determined in the owner's functional currency to correspond to the amount that would have been determined if cost recovery deductions that are inventoriable costs had been translated at the historic rate, as other cost recovery deductions are translated. To enhance administrability and respond to comments received, this adjustment is taken into account in determining COGS in full in the taxable year in which the inventoriable cost recovery deductions are allowed, regardless of whether a portion of such costs is capitalized into ending inventory.

The second adjustment required under the simplified inventory method differs for inventory accounted for under the last-in, first-out (LIFO) method and for non-LIFO inventory, to reflect the different cost flow assumptions under these accounting methods. For both non-LIFO and LIFO inventory, the adjustment generally causes the amount of section 987 taxable income or loss taken into account by the owner of a section 987 QBU to correspond over time to the amount that would be taken into account if inventoriable costs were translated at their respective historic rates rather than at the yearly average exchange rate. For non-LIFO inventory, the adjustment is made on an annual basis with respect to beginning inventory. For LIFO inventory, the adjustment is made only when a LIFO layer is liquidated or partially liquidated.

i. adjustment for non-LIFO inventory

For non-LIFO inventory, the second adjustment required under the simplified inventory method is an adjustment with respect to beginning inventory. The adjustment, which must be made annually, corrects the distortion that arises from translating beginning inventory at the current yearly average exchange rate as part of translating COGS, after the same inventory was translated in the immediately preceding year (when the inventory represented ending inventory in the cost of goods calculation) at the yearly average exchange rate for that year. This adjustment to COGS is calculated as the amount of beginning inventory, computed in the functional currency of the QBU, multiplied by the amount (whether positive or negative) that is determined by subtracting the yearly average exchange rate for the current taxable year from the yearly average exchange rate for the immediately preceding taxable year. For example, in a period in which the functional currency of a section 987 QBU has strengthened against the owner's functional currency, this adjustment would reduce the amount of COGS determined in the owner's functional currency by the difference between beginning inventory translated at the current yearly average exchange rate and at the yearly average exchange rate for the immediately preceding taxable year.

Over time, this adjustment generally causes the owner of a section 987 QBU to take into account the same amount of section 987 taxable income or loss as would have occurred under the 2006 proposed regulations if the yearly average exchange rate had been used as the historic rate. Additionally, because this adjustment is reflected in section 987 taxable income or loss, which is a component of the § 1.987–4 calculation of section 987 gain or loss with respect to the section 987 QBU, the adjustment ultimately has the effect of preventing non-LIFO inventory on the year-end balance sheet from giving rise to section 987 gain or loss, notwithstanding that the historic rate at which it is translated each year is the yearly average exchange rate.

ii. adjustment for LIFO inventory

For LIFO inventory, the second adjustment required under the simplified inventory method is an adjustment with respect to LIFO layers liquidated in whole or part during the year. The adjustment, which must be made only in taxable years in which a LIFO layer is partially or fully liquidated, compensates for the translation of COGS attributable to a liquidated LIFO layer at the current yearly average exchange rate rather than at the historic rate associated with the taxable year in which the inventory layer arose. The adjustment is calculated as the amount of each LIFO layer that has been fully or partially liquidated during the year multiplied by the amount (whether positive or negative) that is determined by subtracting the yearly average exchange rate for the current taxable year from the yearly average exchange rate for the taxable year to which the liquidated layer relates.

As a result of this adjustment, each LIFO layer is treated as having a single historic rate, which is the yearly average exchange rate for the taxable year in which the layer arose.

b. Determination of the OFCNV of inventory under the simplified method

For purposes of determining section 987 gain or loss under § 1.987–4 with respect to inventory that is reflected on the section 987 QBU's year-end balance sheet, § 1.987–1(c)(3)(i)(B) provides a simplified historic rate for inventory to which the simplified inventory method applies. Under § 1.987–1(c)(3)(i)(B), the simplified historic rate for inventory differs depending on whether the inventory is accounted for under the LIFO method. If the inventory is accounted for under the LIFO method, the historic rate is the average exchange rate for the taxable year in which the relevant LIFO layer arose. If the inventory is accounted for under a non-LIFO method, the historic rate is the average exchange rate for the taxable year for which the determination of the historic rate is relevant. Accordingly, for purposes of determining section 987 gain or loss with respect to non-LIFO inventory reflected on a section 987 QBU's year-end balance sheet, the inventory is translated at the average exchange rate for that taxable year. Thus, although non-LIFO inventory subject to the simplified method is nominally a historic asset, it is translated at a current exchange rate each year similar to a marked asset, but using the yearly average exchange rate rather than the year-end spot rate.

4. Translation Rates Used for the Sale of a Marked Asset by a Section 987 QBU

The 2006 proposed regulations provided special rules for translating the adjusted basis and amount realized upon a disposition of a marked asset. For a marked asset that was held by a section 987 QBU on the first day of a taxable year, the required translation rate for the adjusted basis and amount realized with respect to the asset was the rate used to translate the basis of such asset from the section 987 QBU's functional currency into the owner's functional currency in determining the owner functional currency net value of the section 987 QBU for the preceding taxable year under § 1.987–4. For a marked asset acquired during the taxable year, the adjusted basis and amount realized were translated at the spot rate on the date the asset was acquired. In response to general comments on the complexity of administering the 2006 proposed regulations, and considering the relatively minor distortion that would arise from eliminating these special translation rules, the final regulations do not include a special rule for translating the adjusted basis or amount realized with respect to marked assets. Accordingly, the gain or loss on marked assets generally is determined in the functional currency of the section 987 QBU and translated into the owner's functional currency at the yearly average exchange rate for the year of disposition.

B. *Excluded entities*

The 2006 proposed regulations provided that banks, insurance companies, and similar financial entities would not be subject to the regulations. In addition, the 2006 proposed regulations identified leasing companies, finance coordination centers, regulated investment companies, and real estate investment trusts as "similar financial entities." A comment requested that the final regulations clarify the meaning of "similar financial entities." Comments also suggested excluding entities from the scope of "similar financial entity" (and therefore making such entities subject to the final regulations) if they primarily engage in transactions with related parties that are not themselves financial entities. A comment noted that it would be anomalous to apply the final regulations with respect to all of the operating entities transacting with a related finance coordination center but not apply the final regulations to the center itself.

The Treasury Department and the IRS agree that the reference to "similar financial entities" in the 2006 proposed regulations is unclear and agree that entities primarily engaged in transactions with related persons that are not themselves financial entities should be subject to the final regulations. Accordingly, § 1.987–1(b)(1)(ii) omits the reference to "similar financial entities," and replaces it with specific references to the entities that the 2006 proposed regulations explicitly identified as "similar financial entities." Additionally, the exception from the application of the final regulations is revised based on the comment received to not apply (such that the final regulations do apply) to

entities that engage in transactions primarily with persons that are related within the meaning of sections 267(b) or 707(b) and that are not themselves entities identified in § 1.987–1(b)(1)(ii).

The preamble to the 2006 proposed regulations requested comments on the application of the FEEP method to entities excluded from the scope of the 2006 proposed regulations. The Treasury Department and the IRS are still considering how section 987 should apply to excluded entities and request additional comments regarding the appropriate design of rules applying section 987 to excluded entities in light of the rules contained in these final regulations and the temporary regulations. Until regulations providing rules for applying section 987 with respect to such excluded entities are effective, the excluded entities must use a reasonable method to comply with section 987 and cannot rely on these final regulations.

C. ***Election to apply section 988 in lieu of section 987***

A comment recommended allowing an owner of a section 987 QBU that has a relatively small amount of marked items to elect to not apply section 987 with respect to the QBU and instead to apply section 988 with respect to the items that would be considered marked items of the QBU if section 987 applied. The same comment recommended that the Treasury Department and the IRS consider providing such an election more generally without regard to the relative amount of marked items held by an eligible QBU. The Treasury Department and the IRS have determined that the proposed election would create substantial administrative difficulties for the IRS, particularly given that an electing QBU would maintain books and records in its functional currency but would determine tax consequences by reference to the functional currency of the owner. Accordingly, the recommendation to allow an election not to apply section 987 has not been adopted.

D. ***Definition of portfolio stock***

Under § 1.987–2(b)(2) of the 2006 proposed regulations, stock other than portfolio stock is not attributed to an eligible QBU even if it is reflected on the books and records of the eligible QBU. For this purpose, the 2006 proposed regulations provided that stock is portfolio stock if the owner of the eligible QBU owns (directly, indirectly, or constructively) less than 10 percent of the voting power or value of all classes of stock of the corporation. A comment recommended that this rule be based solely on value because voting power should not be a relevant factor in determining whether items of income, gain, deduction, and loss arising from stock are included in section 987 taxable income or loss. The Treasury Department and the IRS agree with this recommendation, which is reflected in § 1.987–2(b)(2).

E. ***Consistency of attribution rules and QBU concept across subpart J***

A comment observed that the 2006 proposed regulations provide rules for attributing assets and liabilities, and items of income or expense, to an eligible QBU and that those rules should apply for purposes of sections 985, 987, and 989 to avoid inconsistencies across subpart J. Accordingly, § 1.989(a)–1(d)(3) is revised to provide that the principles of § 1.987–2(b) apply in determining whether an asset, liability, or item of income or expense is properly reflected on the books and records of a QBU.

To further enhance consistency, the definition of an eligible QBU in § 1.987–1(b)(3) is revised to cross-reference the QBU definition under § 1.989–1(a). The 1991 proposed regulations generally would have applied to a QBU within the meaning of § 1.989(a)–1 that has a functional currency different than the functional currency of its owner. The 2006 proposed regulations, in contrast, did not refer directly to the § 1.989–1(a) QBU definition. Rather, the 2006 regulations generally defined an eligible QBU as activities that constitute a trade or business as defined in § 1.989(a)–1(c) for which a separate set of books and records are maintained. By relying on the definition of a QBU in § 1.989(a)–1, as the 1991 proposed regulations did, the final regulations avoid inadvertently introducing inconsistencies across subpart J in the definition of a QBU.

F. *Offsetting positions*

Under § 1.987–2(b)(3)(iii)(C) of the 2006 proposed regulations, if a principal purpose of recording (or failing to record) an item on the books and records of an eligible QBU was the avoidance of U.S. tax under section 987, the Commissioner could reallocate any item between or among the eligible QBU, its owner, and other persons, entities, or eligible QBUs. One relevant factor identified in the 2006 proposed regulations as indicating tax avoidance as a principal purpose of recording (or failing to record) an item on the books and records of an eligible QBU was the presence or absence of an item on such books and records that results in the taxpayer (or a person related to the taxpayer as defined in section 267(b) or 707(b)) having offsetting positions in the functional currency of a section 987 QBU. The “offsetting position” concern might arise, for example, when a home office borrows funds denominated in the functional currency of a section 987 QBU and then onlends those funds to its section 987 QBU. Since the intra-taxpayer loan is not recognized, the funding transaction booked to the home office will be a section 988 transaction and the cash booked to the section 987 QBU derived from the funding transaction will be subject to section 987. A comment recommended that the Treasury Department and the IRS restrict the parameters of the “offsetting position” factor, particularly in the context of banks.

As discussed in Part II.B of this preamble, these regulations do not apply to banks. Accordingly, this comment will be reconsidered when regulations applying section 987 to banks and other financial entities are developed. Outside of the financial entity context, the Treasury Department and the IRS have determined that the “offsetting position” factor in § 1.987–2(b)(3)(iii)(C) is

necessary to prevent the use of transactions involving offsetting gains and losses to selectively recognize losses without recognition of gain. Accordingly, the recommendation to restrict the parameters of the "offsetting position" factor has not been adopted.

G. *Exclusion of ordinary-course transactions from the definition of a transfer*

Several comments recommended that transactions entered into between two section 987 QBUs of the same taxpayer, or by a section 987 QBU and its home office, in the ordinary course of business should not be considered "transfers" that are taken into account in determining the amount of a remittance. These comments noted the complexity associated with tracking a large number of ordinary-course transactions and contended that such transactions were not appropriate occasions to recognize section 987 gain or loss.

The Treasury Department and the IRS have determined that it is not feasible to define the parameters of an ordinary-course exception to the definition of a transfer with sufficient clarity to avoid abuse and permit effective enforcement given the potentially high volume and variety of transactions between a section 987 QBU and its home office. More significantly, determining the net transfer to or from a section 987 QBU, without regard to whether transfers occur in the ordinary course of business, is essential for appropriately determining section 987 gain or loss under § 1.987–4 because all transfers affect the OFCNV of the section 987 QBU. Furthermore, the Treasury Department and the IRS have determined that the annual netting convention of § 1.987–5, which simplifies the calculation of a remittance relative to the 1991 proposed regulations by taking into account only the net transfer to or from a section 987 QBU during a taxable year, appropriately limits the extent to which ordinary course transactions between a section 987 QBU and its home office give rise to a remittance. Accordingly, the recommendation to include an ordinary-course exception to the definition of transfer has not been adopted.

A comment also recommended that the final regulations permit taxpayers to elect to treat disregarded sales of property and services in the ordinary course of business as regarded transactions. The Treasury Department and the IRS have determined that this recommendation, which would result in income or loss recognition on intra-taxpayer transactions, is inconsistent with the paradigm of section 987 and the entity classification regulations under section 7701. Accordingly, the recommendation has not been adopted.

H. *Extension of the grouping rules*

Section 1.987–1(b)(2)(ii) of the 2006 proposed regulations allows a taxpayer to elect to treat all of its directly owned section 987 QBUs with the same functional currency as a single QBU for purposes of section 987. This rule, however, does not allow different members of a consolidated group to group their section 987 QBUs with the same currency into a single QBU. In the preamble to the 2006 proposed regulations, the Treasury Department and the IRS requested

comments on whether a grouping election should be allowed with respect to section 987 QBUs owned by different members of a consolidated group and how this election should be technically effectuated.

Several comments recommended extending the grouping rules to corporations that file a consolidated return so that a consolidated group could make transfers among section 987 QBUs without causing a remittance. However, based on the comments received, the Treasury Department and the IRS have been unable to reconcile in a satisfactory manner the timing of section 987 gain or loss and section 987 taxable income or loss under the final regulations with the principles of § 1.1502–13, including separate entity accounting for consolidated group members. As a result, this recommendation has not been adopted in the final regulations. The Treasury Department and the IRS continue to welcome comments with specific recommendations regarding how grouping of section 987 QBUs owned by different consolidated group members could be achieved in a manner consistent with the consolidated return regulations.

A comment requested an election to group section 987 QBUs that are directly owned with section 987 QBUs that are indirectly owned through section 987 aggregate partnerships. The Treasury Department and the IRS have determined that allowing grouping of directly and indirectly owned section 987 QBUs would be inconsistent with the treatment of transactions between a partnership and its partner (and between eligible QBUs of the partnership and of the partner) as regarded transactions for Federal income tax purposes. Additionally, it is unclear how the treatment of directly and indirectly owned section 987 QBUs as a single section 987 QBU could be reconciled with the general requirement under sections 702 and 703 that a partnership determine its income separately. Due to the uncertainties about how directly and indirectly owned section 987 QBUs could be grouped in a manner consistent with the principles of subchapter K, the recommendation has not been adopted.

A comment requested that an owner be permitted to elect to group less than all of its section 987 QBUs with the same functional currency. The Treasury Department and the IRS observe that it is possible for an owner to have section 987 gain with respect to some of its section 987 QBUs and section 987 loss with respect to other section 987 QBUs with the same functional currency. In light of this possibility, the Treasury Department and the IRS are concerned that the ability to group section 987 QBUs without the constraint of a consistency requirement for all section 987 QBUs with the same functional currency could inappropriately facilitate the recognition of section 987 losses coupled with the deferral of section 987 gains. Accordingly, the recommendation has not been adopted.

I. *Adjustment of the computation of net unrecognized exchange gain or loss for tax-exempt income and non-deductible expenses*

Section 1.987–4 of the 2006 proposed regulations provided a seven-step process for determining the unrecognized section 987 gain or loss of a section 987 QBU for a taxable year. Comments noted that this calculation did not take

into account the effects of tax-exempt income and non-deductible expenses on a section 987 QBU's cash flows. The comments advised that this omission would introduce distortions into the calculation of unrecognized section 987 gain or loss for a taxable year since these items affect a section 987 QBU's balance sheet. In response to these comments, § 1.987–4(d) reflects additional steps in the calculation of unrecognized section 987 gain or loss that account for nondeductible expenses (Step 7) and tax-exempt income (Step 8). Step 7 also now explicitly accounts for foreign taxes claimed as a credit, which must be translated at the same rate at which such taxes were translated under section 986(a).

J. *Clarification that the rules of §§ 1.987–3 and –4 apply for determining the E&P of a corporation*

Comments indicated that the 2006 proposed regulations did not clearly specify whether the rules provided for determining section 987 taxable income or loss applied for purposes of determining the earnings and profits of a foreign corporation. Accordingly, § 1.987–3(a) clarifies that a foreign corporation that owns a section 987 QBU must apply § 1.987–3 in determining earnings and profits with respect to the section 987 QBU.

K. *FEEP annual calculation requirement*

Section 1.987–4(a) of the 2006 proposed regulations required the determination of the net unrecognized section 987 gain or loss of a section 987 QBU by the owner annually. In addition, § 1.987–9 of the 2006 proposed regulations required the taxpayer to keep annual records that are sufficient to establish each section 987 QBU's section 987 gain or loss. A comment requested elimination of these annual calculations and recordkeeping requirements. The Treasury Department and the IRS remain of the view that the annual calculation and recordkeeping requirements are necessary for IRS examiners to verify taxpayer compliance with the final regulations. Based on its experience examining taxpayer positions that relate to events in prior years, the IRS has determined that contemporaneous recordkeeping and calculation requirements provide a significantly more reliable basis for verifying compliance than calculations performed years after the relevant events, which in many cases would be performed by individuals without direct access to the individuals most familiar with the underlying facts or responsible for producing and maintaining the records. Accordingly, the annual requirements have been retained.

L. *Character and source of section 987 gain or loss*

Consistent with the 1991 proposed regulations, the 2006 proposed regulations required the owner of a section 987 QBU to determine the character and source of section 987 gain or loss for all purposes of the Code, including for determining the extent to which section 987 gain or loss gives rise to subpart F income. In particular, § 1.987–6(b)(2) of the 2006 proposed regulations required

the owner to use the asset method under § 1.861–9T(g) in the year of a remittance to characterize and source section 987 gain or loss for all purposes by reference to the assets of the section 987 QBU.

A comment recommended an exception that would allow a taxpayer to elect to trace identified amounts of section 987 gain or loss to particular assets or liabilities and to characterize such gain or loss by reference to the income or expense derived (or to be derived) from such items. The Treasury Department and the IRS have determined that tracing section 987 gain or loss to particular assets and liabilities is inconsistent with the FEEP method, which aggregates and pools section 987 gain and loss for all assets and liabilities and for all years prior to a remittance. Accordingly, the Treasury Department and the IRS decline to adopt this comment.

A comment questioned whether section 987(3), which refers to sourcing section 987 gain or loss by reference to post-1986 accumulated earnings, provided a sufficient basis for characterizing section 987 gain or loss as subpart F income. The comment recommended against treating section 987 gain as subpart F income but also recommended that, if it were so treated, the final regulations provide a business needs exception similar to that under section 954(c)(1)(D). Another comment acknowledged the Treasury Department's authority under section 989(c)(5) to characterize section 987 gain as subpart F income but questioned the consistency of the requirement in the 2006 proposed regulations to use the asset method of § 1.861–9T to characterize section 987 gain or loss with the reference in section 987(3) to sourcing section 987 gain or loss by reference to post-1986 accumulated earnings. The comment recommended that the character and source of section 987 gain or loss be determined by reference to post-1986 accumulated earnings.

The Treasury Department and the IRS have determined that sourcing and characterizing section 987 gain or loss with direct reference to post-1986 accumulated earnings would give rise to substantial complexity and compliance burdens, including the need to track earnings of a section 987 QBU in separate categories over a long period of time. This approach also presents conceptual difficulties, given that section 987 gain or loss arises from marked assets and liabilities rather than accumulated earnings, and allows for planning opportunities if there are deficits in post-1986 accumulated earnings. The Treasury Department and the IRS continue to believe that, as noted in the preamble to the 2006 proposed regulations, the average tax book value of assets is a reasonable proxy for post-1986 accumulated earnings in the context of section 987. For these reasons, the Treasury Department and the IRS decline to adopt this recommendation. Pursuant to sections 987(3) and 989(c)(5), these regulations follow the approach of the 2006 proposed regulations in requiring the owner to use the asset method of § 1.861–9T(g) to characterize and source section 987 gain or loss. The final regulations, however, do clarify that in applying the asset method, an owner must consistently determine the value of a section 987 QBU's assets on the basis of either the tax book value or the fair market value of the assets.

Additionally, given the significant symmetry (other than timing) between the FEEP paradigm and section 988, the Treasury Department and the IRS have determined that, for purposes of determining the excess of foreign currency gains over foreign currency losses characterized as foreign personal holding company income under section 954(c)(1)(D), it is appropriate for taxpayers to treat section 987 gain or loss that is characterized by reference to assets that give rise to subpart F income as foreign currency gain or loss attributable to section 988 transactions not directly related to the business needs of the controlled foreign corporation (CFC). This policy, which has been adopted in § 1.987–6(b)(3), will allow taxpayers to offset a section 987 net loss characterized by reference to assets that give rise to subpart F income against a section 988 net gain, and vice versa, in determining subpart F income. Section 987 gain or loss characterized by reference to assets that give rise to subpart F income is treated as attributable to section 988 transactions not directly related to the business needs of the CFC because the Treasury Department and the IRS have determined that using the asset method of § 1.861–9T(g) to characterize and source section 987 gain or loss effectively carries out the purpose of the business needs exclusion of section 954(c)(1)(D). In particular, because the asset method characterizes section 987 gain or loss based on whether assets give rise to subpart F income, section 987 gain or loss will not enter into the determination of foreign personal holding company income to the extent assets of the section 987 QBU do not give rise to subpart F income.

M. *Partnerships*

The 2006 proposed regulations applied to all partnerships based on an approach (the aggregate approach) that treated a partnership as an aggregate of its partners, rather than as an entity separate from its partners. As explained in the preamble to the 2006 proposed regulations, the Treasury Department and the IRS proposed the aggregate approach because it appropriately determines section 987 gain or loss with respect to partnership assets and liabilities by reference to the functional currencies of the partners that ultimately bear the economic exposure to fluctuations in the exchange rate between their own functional currency and the functional currency of the activities of the partnership. Accordingly, under §§ 1.989(a)–1(b)(2)(i) of the 2006 proposed regulations, a partnership itself was not treated as a section 987 QBU, but certain activities of a partnership that constituted a trade or business could qualify as a QBU that is an eligible QBU of a partner. Thus, a partner generally was treated as owning an eligible QBU consisting of a share of the assets and liabilities held in the partnership's trade or business. Such an eligible QBU could qualify as a section 987 QBU if it had a functional currency different from that of the partner.

Comments requested that the Treasury Department and the IRS reconsider this aggregate approach and that final regulations instead treat a partnership as a separate entity with its own functional currency. The comments generally were premised on the concern that the aggregate approach was overly complex and that minority partners would not have the power to compel a partnership to

provide them with the information needed to make the calculations required under the aggregate approach. One comment acknowledged the economic rationale for the aggregate approach but, in light of its complexity, recommended that it apply only in cases in which a partner's interest in partnership capital or profits exceeds a certain threshold, such as 10 percent.

The Treasury Department and the IRS acknowledge the concerns expressed about the complexity of applying the aggregate approach in the context of partnerships with partners that are unrelated to each other. Nonetheless, consistent with the comment recommending the aggregate approach for partners with substantial partnership interests, the Treasury Department and the IRS have determined that it is feasible to administer the aggregate approach with respect to a partnership that is wholly owned by related persons. Moreover, adopting the aggregate approach in that context is important for preventing planning opportunities that would arise if the interposition of a partnership within a group of related parties could significantly alter the results that the group otherwise would experience under section 987 without meaningfully altering the group's economic position. Accordingly, the final section 987 regulations retain the aggregate approach of the 2006 proposed regulations only for so-called "section 987 aggregate partnerships," which are defined in § 1.987–1(b)(5) as partnerships for which all of the capital and profits interests are owned, directly or indirectly, by persons that are related within the meaning of section 267(b) or 707(b). The final regulations reflect a conforming amendment to the definition of a QBU at § 1.989(a)–1(b)(2)(i)(C), which now provides that a partnership, other than a section 987 aggregate partnership, is a QBU.

The 2006 proposed regulations provided a rule for determining a partner's share of the assets and liabilities of an eligible QBU owned indirectly through a partnership. Specifically, § 1.987–7(b) provided that a partner's share of assets and liabilities reflected on the books and records of the eligible QBU must be determined in a manner consistent with how the partners have agreed to share the economic benefits and burdens corresponding to partnership assets and liabilities, taking into account the rules and principles of subchapter K. One comment noted that this rule for allocating assets and liabilities to a partner's indirectly owned section 987 QBU was ambiguous and that the rules and principles of subchapter K do not provide sufficient guidance in this regard. Accordingly, as discussed in the preamble to the temporary regulations, the temporary regulations provide more specific rules for determining a partner's share of the assets and liabilities reflected on the books and records of an eligible QBU owned indirectly through a section 987 aggregate partnership.

As previously discussed in this section, comments recommended that the Treasury Department and the IRS consider adopting an entity approach with respect to partnerships. Under the recommended entity approach, a partnership would have its own functional currency and would apply section 987 with respect to each of its section 987 QBUs to determine its taxable income or loss and section 987 gain or loss in that functional currency. Each partner

then would be required to take into account its share of the section 987 taxable income or loss and section 987 gain or loss of the partnership, translated into the partner's functional currency at the average exchange rate for the partner's taxable year.

Although the Treasury Department and the IRS have determined that the aggregate approach is appropriate for applying section 987 to section 987 aggregate partnerships, the Treasury Department and the IRS anticipate that regulations for applying section 987 to other partnerships (non-aggregate partnerships) will be developed under a separate project and may adopt a different approach. Accordingly, the Treasury Department and the IRS request comments describing how an entity approach might apply to non-aggregate partnerships, including comments on (1) whether and how section 987 should apply to marked items denominated in the non-aggregate partnership's functional currency, (2) the information reporting that would be necessary to apply an entity approach, (3) whether a distinction should be made regarding how section 987 applies with respect to partnerships in which significant U.S. partners and CFCs together own more than 50 percent of the capital and profits interests in the partnership, and (4) the rules that would be needed to coordinate with subchapter K.

N. *Terminations*

Under the 2006 proposed regulations, a section 987 QBU terminates when the activities of the section 987 QBU cease, substantially all of the assets of the section 987 QBU are transferred to its owner, a CFC owner of a section 987 QBU ceases being a CFC, or the owner of the section 987 QBU ceases to exist in a transaction other than certain liquidations and reorganizations described in section 381(a). The preamble to the 2006 proposed regulations requested comments on whether transfers of some or all of the assets of a section 987 QBU from one member of a consolidated group to another member of the group should result in a remittance or termination, respectively. Several comments supported a rule under which a section 351 transfer of some or all of the assets of a section 987 QBU to other members of a consolidated group would not cause a remittance or termination where those assets continue to be held in a section 987 QBU following the transaction.

The Treasury Department and the IRS remain of the view that a transfer of substantially all of a section 987 QBU's assets and liabilities under section 351 should result in a termination under § 1.987–8(b)(2) because the owner ceases to be subject to section 987 with respect to the section 987 QBU and has no successor in a section 381(a) transaction. Nonetheless, the Treasury Department and the IRS agree that it is appropriate in certain circumstances to defer section 987 gain or loss that otherwise would be recognized as a result of certain transactions, including terminations, that result in deemed transfers from a section 987 QBU where some or all of the assets of the section 987 QBU continue to be reflected on the books and records of a section 987 QBU in the same controlled group. Additionally, the Treasury Department and the IRS have

determined that combinations and separations of section 987 QBUs of the same owner generally should not result in recognition of section 987 gain or loss. As discussed in the preamble to the temporary regulations, the temporary regulations provide rules under which certain section 987 gain or loss that otherwise would be recognized upon a combination, separation, termination, or other event with respect to a section 987 QBU is deferred and recognized upon a subsequent event to the extent assets of the section 987 QBU continue to be reflected on the books and records of a section 987 QBU in the same controlled group. Under these rules, a section 351 transfer of some or all of the assets of a section 987 QBU within a consolidated group generally would not result in recognition of section 987 gain or loss, provided the transferred assets continue to be reflected on the books and records of a section 987 QBU.

Comments recommended eliminating the rule in the 2006 proposed regulations under which a section 987 QBU terminates upon its owner ceasing to be a CFC. The comments indicated that the rule is inconsistent with the policy of subpart F and section 1248. One of the comments questioned the authority under subpart J for such a rule. A comment also recommended that the final regulations eliminate the rule under which a section 987 QBU terminates when it is acquired by a non-CFC from a CFC owner in a reorganization in which the CFC owner goes out of existence but has a successor under section 381(a). The Treasury Department and the IRS acknowledge that the policy concern motivating these rules pertains primarily to situations in which a section 987 QBU ceases to be owned by a CFC but continues to be owned by related persons within the meaning of section 267(b). Accordingly, consistent with section 989(c)(5), a section 987 QBU will terminate under § 1.987–8(b)(3), (b)(4) and (c) only in that circumstance.

Comments indicated that it was unclear under the 2006 proposed regulations whether a check-the-box election to treat a foreign disregarded entity that legally owns a section 987 QBU as a corporation for U.S. tax purposes would cause the section 987 QBU to terminate. To provide greater clarity, *Example 6* in § 1.987–8(f) illustrates that when a foreign disregarded entity that legally owns a section 987 QBU elects to be treated as a corporation under the check-the-box regulations in § 301.7701–3, the section 987 QBU terminates due to the deemed transfer of assets from the section 987 QBU to the owner immediately prior to the deemed transfer of assets from the owner to the transferee corporation under section 351. Additionally, § 1.987–2(c)(2)(ii) clarifies that if an asset or liability of a section 987 QBU is sold or exchanged (including in a nonrecognition transaction) for an asset or liability that is not attributable to the section 987 QBU immediately after the exchange (for example, non-portfolio stock deemed to be received in a section 351 exchange), the exchanged asset is treated as transferred from the section 987 QBU to its owner in a disregarded transaction immediately before the exchange. This transfer would be taken into account in determining the amount of the remittance from the section 987 QBU under § 1.987–5.

Under the 2006 proposed regulations, a section 987 QBU terminates when its activities cease, such that it no longer meets the definition of an eligible QBU under § 1.987–1(b)(3). For administrative convenience, § 1.987–8(b)(1) reflects a new provision allowing the owner of a section 987 QBU that ceases its trade or business to continue to treat the section 987 QBU as a section 987 QBU for a reasonable period during the wind-up of the trade or business, which period may not exceed two years from the date the section 987 QBU ceases its activities carried on for profit.

O. *Transition rules*

Under the 2006 proposed regulations, a taxpayer that used a reasonable method to comply with section 987 prior to transitioning to the final regulations could choose between the deferral transition method and the fresh start transition method. The deferral transition method generally preserved section 987 gain or loss determined under the taxpayer's prior method, whereas the fresh start method did not.

Under the deferral transition method, a taxpayer would determine section 987 gain or loss under the taxpayer's prior method as if all section 987 QBUs of the taxpayer terminated on the last day of the taxable year preceding the transition date. Such section 987 gain or loss was not recognized but rather was considered as net unrecognized section 987 gain or loss of new section 987 QBUs for purposes of applying section 987 to the taxable year that begins on the transition date. The owner of a section 987 QBU that was deemed terminated under this rule was treated as having transferred all of the assets and liabilities attributable to such section 987 QBU to the new section 987 QBU on the transition date. Exchange rates for translating the amounts of assets and liabilities transferred to the new section 987 QBU were determined with reference to the historic spot rates for such assets and liabilities, adjusted to take into account gain or loss determined on the deemed termination.

Under the fresh start transition method, the same deemed transactions would be deemed to occur as under the deferral transition method, but no section 987 gain or loss would be determined upon the deemed termination. Exchange rates for translating the amounts of assets and liabilities deemed transferred to the new section 987 QBU were determined with reference to the historic spot rates for such assets and liabilities without adjustment. Accordingly, section 987 gain or loss determined under the owner's prior method was not taken into account. Except to the extent of any previously recognized section 987 gain or loss, the effect of the fresh start method is as if the assets and liabilities on the books and records of a section 987 QBU on the transition date had been the only assets and liabilities held by the QBU from its inception.

The Treasury Department and the IRS received several comments recommending changes to the transition rules under § 1.987–10 of the 2006 proposed regulations. One comment recommended that the deferral transition method be eliminated. The comment stated that the availability of two transition methods seemed overly generous to taxpayers and that the fresh

start method was sufficient. The comment further noted that the effect of the elections made by taxpayers would be very one-sided in a manner detrimental to the fisc. Another comment recommended that taxpayers be permitted to elect a “true fresh start” method that would translate all assets and liabilities on the first opening balance sheet after the transition at the spot rate on the date of transition and therefore disregard any section 987 gain or loss attributable to the assets and liabilities of the QBU for periods prior to the transition date.

The Treasury Department and the IRS agree with the comment that suggested that the fresh start method is sufficient and that the availability of an election between two different transition methods is unnecessary and detrimental to the fisc. By requiring the translation of assets and liabilities of transitioning QBUs at historic rates, unlike the “true fresh start” method suggested by a comment, the fresh start transition method appropriately takes into account the applicability of section 987 prior to the issuance of final regulations. Allowing an election to use the deferral method would allow taxpayers with substantial overall section 987 losses determined under their prior method, which may not correspond to economic losses, to preserve those losses while taxpayers with substantial overall section 987 gains determined under their prior method could avoid taking some of those gains into account by using the fresh start method. Such an election effectively would operate as a one-time election for certain taxpayers to reduce Federal income tax liability. Additionally, the Treasury Department and the IRS have determined that there would be considerable administrative difficulty, as well as potential for opportunistic planning, associated with determining the appropriate translation rates for transitioning under the deferral method from a section 987 method other than the method of the 1991 proposed regulations. Accordingly, the final regulations do not include an election to use the deferral method. Additionally, the final regulations do not include an election to use a “true fresh start” method, since that method would fail to account in any way for the applicability of section 987 prior to the transition date with respect to assets and liabilities held by a section 987 QBU on the transition date.

A comment recommended that the final regulations provide further guidance on the application of the fresh start method where a taxpayer cannot trace historic spot exchange rates. In response to this comment, § 1.987–10(b)(3) provides that, if a taxpayer cannot reliably determine the historic rate for a particular asset or liability, the historic rate must be determined based on reasonable assumptions consistently applied. In addition, the general rules of § 1.987–1(c)(3)(i)(A) and (D) ease this burden by providing that the historic rate for assets and liabilities is the relevant yearly average exchange rate, rather than the spot rate.

A comment recommended that taxpayers be permitted to elect retroactively to apply the final regulations to all open years. Such an election effectively would operate as one-time election to reduce Federal income tax liability. Additionally, consistent with the discussion in Part II.K of this preamble about the need for contemporaneous recordkeeping, the Treasury Department and the IRS have

determined that retroactive application of the final regulations would present significant administrative and compliance difficulties, given that it would be necessary in many cases to make determinations under the final regulations based on facts that may not be readily ascertainable or verifiable in hindsight. Accordingly, this recommendation has not been adopted.

A comment asserted that taxpayers that recognized section 987 gain or loss under the principles of the 1991 proposed regulations may be treated unfairly relative to taxpayers that did not follow those proposed regulations. To address this perceived unfairness, the comment recommended that taxpayers be permitted to elect to include a section 481(a) adjustment to account for the difference between the amount of section 987 gain or loss that was taken into account under the taxpayer's prior method and the amount that would have been determined under the method in the final regulations. As an initial matter, it is not evident to the Treasury Department and the IRS that any inequity could result from a taxpayer's chosen method of applying section 987, given that, in the absence of applicable regulations, taxpayers have been permitted to apply section 987 using any reasonable method. Regardless of any perceived inequity, however, as discussed earlier in this Part II.O of the preamble, the Treasury Department and the IRS have determined that the fresh start transition method is the appropriate method for transitioning section 987 QBUs to the final regulations. Under the fresh start transition method, unrecognized section 987 gain or loss determined under a prior section 987 method is not taken into account, and marked assets and liabilities reflected on a section 987 QBU's balance sheet on the transition date are translated using a historic rate. These rules, together with the requirement under § 1.987–10(d) to adjust unrecognized section 987 gain or loss to prevent double counting, have a similar effect as allowing a section 481(a) adjustment with respect to section 987 gain or loss arising from assets and liabilities reflected on a section 987 QBU's transition date balance sheet. Additionally, it is unclear how a section 481(a) adjustment could apply with respect to section 987 gain or loss arising from assets and liabilities that are no longer on the balance sheet on the transition date, absent a requirement to redetermine section 987 gain or loss as if the final regulations had applied from the inception of the QBU. For the reasons described in Part II.K of this preamble, the Treasury Department and the IRS have determined that such a requirement would be inadministrable. Furthermore, the Treasury Department and the IRS are concerned that an election to compute a full section 481(a) adjustment, like an election to use the deferral method, effectively would operate as a one-time election to reduce Federal income tax liability. Accordingly, for the foregoing reasons, this recommendation has not been adopted.

The Treasury Department and the IRS recognize that certain taxpayers have adopted a section 987 method based on a reasonable application of the 2006 proposed regulations (2006 method). Taxpayers that adopted the 2006 method generally already transitioned to that method in accordance with the principles § 1.987–10 of the 2006 proposed regulations. Because the final regulations adopt the 2006 proposed regulations without fundamental changes, it is not

necessary or appropriate for taxpayers to transition from the 2006 method to the final regulations under the fresh start method. However, § 1.987–10(c)(2) provides rules clarifying how net unrecognized section 987 gain or loss with respect to a QBU that was subject to the 2006 method is determined under the final regulations. Additionally, because the 2006 proposed regulations required the use of a spot rate for the historic rate and the final regulations specify as a general rule that the historic rate is the yearly average exchange rate, § 1.987–10(c)(3) permits taxpayers to use historic rates determined under their prior 2006 method for assets and liabilities reflected on the balance sheet of a transitioning QBU on the transition date.

P. *Elections*

Several elections have been included in the final regulations to mitigate potential complexity or administrative burden associated with complying with these regulations. Section 1.987–1(g) provides rules for making elections. As under the 2006 proposed regulations, elections must be made by the owner and must be made for the first taxable year in which the election is relevant in determining the section 987 taxable income or loss or section 987 gain or loss of the section 987 QBU. Elections may not be revoked or changed without the consent of the Commissioner or his delegate. A revocation will be considered if the taxpayer can demonstrate significantly changed circumstances or other circumstances that demonstrate a substantial non-tax business reason for revoking the election.

A comment recommended that the final regulations allow a taxpayer, without the consent of the Commissioner, to adopt or change the translation conventions for any section 987 QBU acquired from an unrelated person in a transaction that does not cause the QBU to terminate. The Treasury Department and the IRS have determined that requiring Commissioner consent to change an election in this circumstance promotes the ability of the IRS to administer the final regulations and does not create an undue burden. Accordingly, this recommendation has not been adopted.

With one exception, the elections under the final regulations are made on a QBU-by-QBU basis. As provided under the 2006 proposed regulations and described in Part II.H of this preamble, an owner must make the grouping election described in § 1.987–1(b)(2)(ii) with respect to all of its section 987 QBUs that have the same functional currency.

The 2006 proposed regulations described elections made under section 987 as methods of accounting but provided procedures for making and revoking such elections that were inconsistent with treating the elections as methods of accounting. This inconsistency is resolved in the final regulations, which do not follow the 2006 proposed regulations in identifying all section 987 elections as methods of accounting and clarify at § 1.987–1(g)(4) that an election under section 987 is not governed by the general rules concerning changes in methods of accounting.

Under § 1.987–1(f) of the 2006 proposed regulations, an election was made by attaching a statement to the timely filed tax return for the first taxable year in which the owner intends the election to be effective. If the owner failed to make an election in a timely manner, the owner was considered to have satisfied the timeliness requirement if (1) the owner was able to demonstrate that the failure was due to reasonable cause and not willful neglect; and (2) once the owner became aware of the failure, the owner attached the election as well as a written statement setting forth the reasons for the failure to timely comply to an amended tax return. The Director of Field Operations had 120 days following the filing to respond if it determined that the failure to comply was not due to reasonable cause or if additional time was needed to make a determination. If the Director did not respond to the taxpayer within 120 days of filing, the owner was deemed to have demonstrated that such failure to timely file was due to reasonable cause.

The Treasury Department and the IRS have determined, in part based on the experience of the IRS in administering other regulations, that the procedures described in the 2006 proposed regulations may inappropriately shift to the IRS a burden that arises in the first instance as a result of a taxpayer's failure to make a timely election. Accordingly, those procedures are not included in the final regulations, and taxpayers who fail to make a timely election may seek relief in accordance with the general rules described in § 301.9100–1 for requesting an extension of time to make an election.

Q. *Other changes*

The final regulations reflect other modifications to the language and structure of the 2006 proposed regulations, as well as the inclusion of additional examples, to enhance clarity. The Treasury Department and the IRS do not intend these changes to be interpreted as substantive changes to the 2006 proposed regulations.

Special Analyses

Certain IRS regulations, including these, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Accordingly, a regulatory flexibility analysis is not required. This certification is based on the fact that these regulations will primarily affect U.S. corporations that have foreign operations, which tend to be larger businesses. Pursuant to section 7805(f) of the Internal Revenue Code, the NPRM preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these final regulations are Mark E. Erwin, Steven D. Jensen and Sheila Ramaswamy of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Amendment to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 987, 989(c), and 7805 * * *

Par. 2. Section 1.861–9T is amended by revising paragraph (g)(2)(ii)(A)(*1*) aind adding paragraph (g)(2)(vi) to read as follows:

§ 1.861–9T Allocation and apportionment of interest expense (temporary).

* * * * *

(g) * * *

(2) * * *

(ii) * * *

(A) * * *

(*1*) *Section 987 QBU*. In the case of a section 987 QBU (as defined in § 1.987–1(b)(2)), the tax book value shall be determined by applying the rules of paragraphs (g)(2)(i) and (g)(3) of this section to the beginning-of-year and end-of-year functional currency amount of assets. The beginning-of-year functional currency amount of assets shall be determined by reference to the functional currency amount of assets computed under § 1.987–4(d)(1)(i)(B) and (e) on the last day of the preceding taxable year. The end-of-year functional currency amount of assets shall be determined by reference to the functional currency amount of assets computed under § 1.987–4(d)(1)(i)(A) and (e) on the last day of the current taxable year. The beginning-of-year and end-of-year functional currency amount of assets, as so determined within each grouping, must then be averaged as provided in paragraph (g)(2)(i) of this section.

* * * * *

(vi) *Effective/applicability date*. Generally, paragraph (g)(2)(ii)(A)(*1*) of this section shall apply to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. If pursuant to § 1.987–11(b) a taxpayer applies §§ 1.987–1 through 1.987–11 beginning in a taxable

year prior to the earliest taxable year described in § 1.987–11(a), then paragraph (g)(2)(ii)(A)(*1*) of this section shall apply to taxable years beginning on or after the first day of such prior taxable year.

* * * * *

Par 3. Section 1.985–5 is revised to read as follows:

***§ 1.985–5 Adjustments required upon change in functional currency*.**

(a) *In general*. This section applies in the case of a taxpayer or qualified business unit (QBU) (including a section 987 QBU (as defined in § 1.987–1(b)(2)) changing from one functional currency (old functional currency) to another functional currency (new functional currency). A taxpayer or QBU subject to the rules of this section shall make the adjustments set forth in the 3-step procedure described in paragraphs (b) through (e) of this section. Except as otherwise provided in this section, the adjustments shall be made on the last day of the last taxable year ending before the year of change (as defined in § 1.481–1(a)(1)). Gain or loss required to be recognized under paragraphs (b), (d)(2), (e)(2), and (e)(4)(iii) of this section is not subject to section 481 and, therefore, the full amount of the gain or loss must be included in income on the last day of the last taxable year ending before the year of change.

(b) *Step 1—Taking into account exchange gain or loss on certain section 988 transactions*. The taxpayer or QBU shall recognize or otherwise take into account for all purposes of the Internal Revenue Code the amount of any unrealized exchange gain or loss attributable to a section 988 transaction (as defined in section 988(c)(1)(A) through (C)) that, after applying section 988(d), is denominated in terms of or determined by reference to the new functional currency. The amount of such gain or loss shall be determined without regard to the limitations of section 988(b) (that is, whether any gain or loss would be realized on the transaction as a whole). The character and source of such gain or loss shall be determined under section 988.

(c) *Step 2—Determining the new functional currency basis of property and the new functional currency amount of liabilities and any other relevant items*. Except as otherwise provided in this section, the new functional currency adjusted basis of property and the new functional currency amount of liabilities and any other relevant items (for example, items described in section 988(c)(1)(B)(iii)) shall equal the product of the old functional currency adjusted basis or liability and the new functional currency/old functional currency spot rate on the last day of the last taxable year ending before the year of change.

(d) *Step 3A—Additional adjustments that are necessary when a QBU changes functional currency*—(1) *QBU changing to a functional currency other than the owner's functional currency*—(i) *Rule*. If a QBU changes its functional currency, and after the change the QBU is a section 987 QBU that is subject to §§ 1.987–1

through 1.987–11 pursuant to § 1.987–1(b)(1), then the adjustments described in either paragraph (d)(1)(ii) or (d)(1)(iii) of this section shall be taken into account for purposes of section 987.

(ii) *QBU and the owner had different functional currencies prior to the change*. If the QBU and the owner of the QBU had different functional currencies prior to the change and as a result the QBU was a section 987 QBU prior to the change, then the adjustments described in paragraphs (d)(1)(ii)(A) and (d)(1)(ii)(B) of this section shall be taken into account.

(A) *Determining new historic rates*. The historic rate (as defined in § 1.987–1(c)(3)) for the year of change and subsequent taxable years with respect to a historic item (as defined in § 1.987–1(e)) reflected on the balance sheet of the section 987 QBU immediately prior to the year of change shall be equal to the historic rate prior to the year of change (that is, a rate that translates the section 987 QBU's old functional currency into the owner's functional currency) divided by the spot rate (as defined in § 1.987–1(c)(1)) for translating an amount denominated in the section 987 QBU's old functional currency into the section 987 QBU's new functional currency on the last day of the last taxable year ending before the year of change. For example, if a taxpayer with a U.S. dollar (USD) functional currency owns a section 987 QBU that changes from a British pound (GBP) functional currency to a euro (EUR) functional currency, the historic rate for translating a specific historic item of this section 987 QBU from GBP to USD is 1.50, and the spot rate for translating GBP to EUR on the last day of the last taxable year before the change is 1.30, then the new historic rate for translating this historic item from EUR to USD is 1.15 (1.50/1.30).

(B) *Determining the owner functional currency net value of the QBU on the last day of the last taxable year ending before the year of change under § 1.987–4(d)(1)(i)(B)*. For purposes of determining the owner functional currency net value of the section 987 QBU on the last day of the last taxable year ending before the year of change under § 1.987–4(d)(1)(i)(B) and § 1.987–4(e), the section 987 QBU's marked items (as defined in § 1.987–1(d)) shall be translated from the section 987 QBU's old functional currency into the owner's functional currency using the spot rate on the last day of the last taxable year ending before the year of change.

(iii) *QBU and the taxpayer had the same functional currency prior to the change*. If a QBU that has the same functional currency as a taxpayer changes its functional currency to a new functional currency that is different than the functional currency of the taxpayer, and as a result the taxpayer becomes an owner of a section 987 QBU (see § 1.987–1), the taxpayer and section 987 QBU will become subject to section 987 for the year of change and subsequent years.

(2) *QBU changing to the owner's functional currency*. If a section 987 QBU changes its functional currency to the functional currency of its owner, the section 987 QBU shall be treated as if it terminated on the last day of the last

taxable year ending before the year of change. See §§ 1.987–5 and 1.987–8 for the effect of a termination of a section 987 QBU that is subject to §§ 1.987–1 through 1.987–11.

(e) *Step 3B—Additional adjustments that are necessary when a taxpayer/owner changes functional currency*—(1) *Corporations*. The amount of a corporation's new functional currency earnings and profits and the amount of its new functional currency paid-in capital shall equal the old functional currency amounts of such items multiplied by the spot rate for translating an amount denominated in the corporation's old functional currency into the corporation's new functional currency on the last day of the last taxable year ending before the year of change. The foreign income taxes and accumulated profits or deficits in accumulated profits of a foreign corporation that were maintained in foreign currency for purposes of section 902 and that are attributable to taxable years of the foreign corporation beginning before January 1, 1987, also shall be translated into the new functional currency at the spot rate.

(2) *Collateral consequences to a United States shareholder of a corporation changing to the United States dollar as its functional currency*. A United States shareholder (within the meaning of section 951(b) or section 953(c)(1)(A)) of a controlled foreign corporation (within the meaning of section 957 or section 953(c)(1)(B)) changing its functional currency to the dollar shall recognize foreign currency gain or loss computed under section 986(c) as if all previously taxed earnings and profits, if any, (including amounts attributable to pre-1987 taxable years that were translated from dollars into functional currency in the foreign corporation's first post-1986 taxable year) were distributed immediately prior to the change.

(3) *Taxpayers that are not corporations*. [Reserved].

(4) *Adjustments to a section 987 QBU's balance sheet and net accumulated unrecognized section 987 gain or loss when an owner changes functional currency*—(i) *Owner changing to a functional currency other than the section 987 QBU's functional currency*. If an owner of a section 987 QBU, subject to §§ 1.987–1 through 1.987–11 pursuant to § 1.987–1(b)(1), changes to a functional currency other than the functional currency of the section 987 QBU, the adjustments described in paragraphs (e)(4)(i)(A) through (C) of this section shall be taken into account for purposes of section 987.

(A) *Determining new historic rates*. The historic rate (as defined in § 1.987–1(c)(3)) for the year of change and subsequent taxable years with respect to a historic item (as defined in § 1.987–1(e)) reflected on the balance sheet of the section 987 QBU immediately prior to the year of change shall be equal to the historic rate prior to the year of change (that is, a rate that translates the section 987 QBU's functional currency into the owner's old functional currency) divided by the spot rate for translating an amount denominated in the owner's new functional currency into the owner's old functional currency on the last day of the last taxable year ending before the year of change. For example, if a taxpayer that owns a section 987 QBU with a British pound functional currency

changes from a U.S. dollar functional currency to a euro functional currency, and the historic rate for translating a specific item of the section 987 QBU from GBP to USD is 1.50 and the spot rate for translating EUR to USD on the last day of the last taxable year before the change is 1.10, then the new historic rate for translating this historic item from GBP to EUR is 1.36 (1.50/1.10).

(B) *Determining the owner functional currency net value of the section 987 QBU on the last day of the last taxable year ending before the year of change under § 1.987–4(d)(1)(i)(B*). For purposes of determining the change in the owner functional currency net value of the section 987 QBU on the last day of the last taxable year preceding the year of change under §§ 1.987–4(d)(1)(i)(B) and 1.987–4(e), the section 987 QBU's marked items shall be translated into the owner's new functional currency at the spot rate on the last day of the last taxable year ending before the year of change.

(C) *Translation of net accumulated unrecognized section 987 gain or loss*. Any net accumulated unrecognized section 987 gain or loss determined under § 1.987–4 shall be translated from the owner's old functional currency into the owner's new functional currency using the spot rate for translating an amount denominated in the owner's old functional currency into the owner's new functional currency on the last day of the last taxable year ending before the year of change.

(ii) *Taxpayer with the same functional currency as its QBU changing to a different functional currency*. If a taxpayer with the same functional currency as its QBU changes to a new functional currency and as a result the taxpayer becomes an owner of a section 987 QBU (see § 1.987–1), the taxpayer and the section 987 QBU shall become subject to section 987 for the year of change and subsequent years.

(iii) *Owner changing to the same functional currency as the section 987 QBU*. If an owner changes its functional currency to the functional currency of its section 987 QBU, the section 987 QBU shall be treated as if it terminated on the last day of the last taxable year ending before the year of change. See §§ 1.987–5 and 1.987–8 for the consequences of a termination of a section 987 QBU that is subject to §§ 1.987–1 through 1.987–11.

(f) *Example*. The provisions of this section are illustrated by the following example:

Example. (i) *Facts*. FC, a foreign corporation, owns all of the stock of DC, a domestic corporation. The Commissioner granted permission to change FC's functional currency from the British pound to the euro beginning January 1, 2020. The EUR/GBP exchange rate on December 31, 2019, is €1:£0.50.

(ii) *Determining new functional currency basis of property and liabilities*. The following table shows how FC must convert the items on its balance sheet from the British pound to the euro on December 31, 2019.

	GBP	**EUR**

	GBP	EUR
Assets:		
Cash on hand	£40,000	€80,000
Accounts Receivable	£10,000	€20,000
Inventory	£100,000	€200,000
€100,000 Euro Bond (£100,000 historical basis)	£50,000	€100,000
Fixed assets:		
Property	£200,000	€400,000
Plant	£500,000	€1,000,000
Accumulated Depreciation	(£200,000)	(€400,000)
Equipment	£1,000,000	€2,000,000
Accumulated Depreciation	(£400,000)	(€800,000)
	———————	————
Total Assets	£1,300,000	€2,600,000
Liabilities:		
Accounts Payable	£50,000	€100,000
Long-term Liabilities	£400,000	€800,000
Paid-in-Capital	£800,000	€1,600,000
Retained Earnings	£50,000	€100,000
	———————	————
Total Liabilities and Equity	£1,300,000	€2,600,000

(iii) *Exchange gain or loss on section 988 transactions*. Under paragraph (b) of this section, FC will recognize a £50,000 loss (£50,000 current value minus £100,000 historical basis) on the Euro Bond resulting from the change in functional currency because, after the change, the Euro Bond will no longer be an asset denominated in a non-functional currency. The amount of FC's retained earnings on its December 31, 2019, balance sheet reflects the £50,000 loss on the Euro Bond.

(g) *Effective/applicability date*. Generally, this regulation shall apply to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. If pursuant to § 1.987–11(b) a taxpayer applies §§ 1.987–1 through 1.987–11 beginning in a taxable year prior to the earliest

taxable year described in § 1.987–11(a), then this section shall apply to taxable years of the taxpayer beginning on or after the first day of such prior taxable year.

Par. 4. Section 1.987–0 is added and §§ 1.987–1 through 1.987–5 are revised to read as follows:

* * * * *

Sec.

1.987–0 Section 987; Table of contents.

1.987–1 Scope, definitions and special rules.

1.987–2 Attribution of items to eligible QBUs; definition of a transfer and related rules.

1.987–3 Determination of section 987 taxable income or loss of an owner of a section 987 QBU.

1.987–4 Determination of net unrecognized section 987 gain or loss of a section 987 QBU.

1.987–5 Recognition of section 987 gain or loss.

* * * * *

§ 1.987–0 Section 987; table of contents.

This section lists captioned paragraphs contained in §§ 1.987–1 through 1.987–11.

***§ 1.987–1 Scope, definitions and special rules*.**

(a) In general.

(b) Scope of section 987 and definitions.

(1) Taxpayers subject to section 987.

(2) Definition of section 987 QBU.

(3) Definition of an eligible QBU.

(4) Definition of owner.

(5) Section 987 aggregate partnership.

(6) [Reserved].

(7) Examples illustrating paragraph (b) of this section.

(c) Exchange rates.

(1) Spot rate.

(2) Yearly average exchange rate.

(3) Historic rate.

(d) Marked item.

(e) Historic item.

(f) [Reserved].

(g) Elections.

(1) In general.

(2) Exceptions to the general rules.

(3) Manner of making elections.

(4) No change in method of accounting.

(5) Revocation of an election.

§ 1.987–2 Attribution of items to eligible QBUs; definition of a transfer and related rules.

(a) Scope and general principles.

(b) Attribution of items to an eligible QBU.

(1) General rules.

(2) Exceptions for non-portfolio stock, interests in partnerships, and certain acquisition indebtedness.

(3) Adjustments to items reflected on the books and records.

(4) Assets and liabilities of a section 987 aggregate partnership or DE that are not attributed to an eligible QBU.

(c) Transfers to and from section 987 QBUs.

(1) In general.

(2) Disregarded transactions.

(3) Transfers of assets to and from section 987 QBUs owned through section 987 aggregate partnerships.

(4) Transfers of liabilities to and from section 987 QBUs owned through section 987 aggregate partnerships.

(5) Acquisitions and dispositions of interests in DEs and section 987 aggregate partnerships.

(6) Changes in form of ownership.

(7) Application of general tax law principles.

(8) Interaction with § 1.988–1(a)(10).

(9) [Reserved].

(10) Examples.

(d) Translation of items transferred to a section 987 QBU.

(1) Marked items.

(2) Historic items.

§ 1.987–3 Determination of section 987 taxable income or loss of an owner of a section 987 QBU.

(a) In general.

(b) Determination of each item of income, gain, deduction, or loss in the section 987 QBU's functional currency.

(1) In general.

(2) Translation of items of income, gain, deduction, or loss that are denominated in a nonfunctional currency.

(3) Determination in the case of a section 987 QBU owned through a section 987 aggregate partnership.

(4) [Reserved].

(c) Translation of items of income, gain, deduction, or loss of a section 987 QBU into the owner's functional currency.

(1) In general.

(2) Exceptions.

(3) Adjustments to COGS required under the simplified inventory method.

(d) [Reserved].

(e) Examples.

§ 1.987–4 Determination of net unrecognized section 987 gain or loss of a section 987 QBU.

(a) In general.

(b) Calculation of net unrecognized section 987 gain or loss.

(c) Net accumulated unrecognized section 987 gain or loss for all prior taxable years.

(1) In general.

(2) [Reserved].

(d) Calculation of unrecognized section 987 gain or loss for a taxable year.

(1) Step 1: Determine the change in the owner functional currency net value of the section 987 QBU for the taxable year.

(2) Step 2: Increase the amount determined in step 1 by the amount of assets transferred from the section 987 QBU to the owner.

(3) Step 3: Decrease the amount determined in steps 1 and 2 by the amount of assets transferred from the owner to the section 987 QBU.

(4) Step 4: Decrease the amount determined in steps 1 through 3 by the amount of liabilities transferred from the section 987 QBU to the owner.

(5) Step 5: Increase the amount determined in steps 1 through 4 by the amount of liabilities transferred from the owner to the section 987 QBU.

(6) Step 6: Decrease or increase the amount determined in steps 1 through 5 by the section 987 taxable income or loss, respectively, of the section 987 QBU for the taxable year.

(7) Step 7: Increase the amount determined in steps 1 through 6 by any expenses that are not deductible in computing the section 987 taxable income or loss of the section 987 QBU for the taxable year.

(8) Step 8: Decrease the amount determined in steps 1 through 7 by the amount of any tax-exempt income.

(e) Determination of the owner functional currency net value of a section 987 QBU.

(1) In general.

(2) Translation of balance sheet items into the owner's functional currency.

(f) [Reserved].

(g) Examples.

§ 1.987–5 Recognition of section 987 gain or loss.

(a) Recognition of section 987 gain or loss by the owner of a section 987 QBU.

(b) Remittance proportion.

(c) Remittance.

(1) Definition.

(2) Day when a remittance is determined.

(3) Termination.

(d) Aggregate of all amounts transferred from the section 987 QBU to the owner for the taxable year.

(e) Aggregate of all amounts transferred from the owner to the section 987 QBU for the taxable year.

(f) Determination of owner's adjusted basis in transferred assets.

(1) In general.

(2) Marked asset.

(3) Historic asset.

(g) Example.

§ 1.987–6 Character and source of section 987 gain or loss.

(a) Ordinary income or loss.

(b) Character and source of section 987 gain or loss.

(1) In general.

(2) Method required to characterize and source section 987 gain or loss.

(3) Coordination with section 954.

(c) Examples.

§ 1.987–7 Section 987 aggregate partnerships.

(a) In general.

(b) [Reserved].

(c) Coordination with subchapter K.

§ 1.987–8 Termination of a section 987 QBU.

(a) Scope.

(b) In general.

(1) Trade or business ceases.

(2) Substantially all assets transferred.

(3) Owner no longer a CFC.

(4) Owner ceases to exist.

(c) Transactions described in section 381(a).

(1) Liquidations.

(2) Reorganizations.

(d) [Reserved].

(e) Effect of terminations.

(f) Examples.

§ 1.987–9 Recordkeeping requirements.

(a) In general.

(b) Supplemental information.

(c) Retention of records.

(d) Information on a dedicated section 987 form.

§ 1.987–10 Transition rules.

(a) Scope.

(b) Fresh start transition method.

(1) In general.

(2) Application of § 1.987–4.

(3) Determination of historic rate.

(4) Example.

(c) Transition of section 987 QBUs that applied the method set forth in the 2006 proposed section 987 regulations.

(1) In general.

(2) Application of § 1.987–4.

(3) Use of prior historic rate.

(4) Example.

(d) Adjustments to avoid double counting.

(e) Reporting.

(1) In general.

(2) Attachments not required where information is reported on a form.

§ 1.987–11 Effective/applicability date.

(a) In general.

(b) Application of these regulations to taxable years beginning after December 7, 2016.

(c) Transition date.

§ 1.987–1 Scope, definitions, and special rules.

(a) *In general*. These regulations under section 987 (§§ 1.987–1 through 1.987–11) provide rules for determining the taxable income or loss of a taxpayer with respect to a section 987 QBU (as defined in paragraph (b)(2) of this section). Further, these regulations provide rules for determining the timing, amount, character, and source of section 987 gain or loss recognized with respect to a section 987 QBU. This section addresses the scope of these regulations and provides certain definitions, special rules, and the procedures for making the elections provided for in the regulations. Section 1.987–2 provides rules for attributing assets and liabilities and items of income, gain, deduction, and loss to an eligible QBU. It also provides rules regarding the translation of items transferred to a section 987 QBU. Section 1.987–3 provides rules for determining

and translating the taxable income or loss of a taxpayer with respect to a section 987 QBU. Section 1.987–4 provides rules for determining net unrecognized section 987 gain or loss. Section 1.987–5 provides rules regarding the recognition of section 987 gain or loss. It also provides rules for determining an owner's basis in assets transferred from a section 987 QBU. Section 1.987–6 provides rules regarding the character and source of section 987 gain or loss. Section 1.987–7 provides rules with respect to section 987 aggregate partnerships. Section 1.987–8 provides rules regarding the termination of a section 987 QBU. Section 1.987–9 provides rules regarding the recordkeeping required under section 987. Section 1.987–10 provides transition rules. Section 1.987–11 provides the effective/applicability date of these regulations.

(b) *Scope of section 987 and definitions*—(1) *Taxpayers subject to section 987*—(i) *In general*. Except as provided in paragraphs (b)(1)(ii) and (b)(6) of this section, an individual or corporation is subject to these regulations under section 987 if such person is an owner (as defined in paragraph (b)(4) of this section) of an eligible QBU (as defined in paragraph (b)(3) of this section) that is a section 987 QBU (as defined in paragraph (b)(2) of this section).

(ii) *Inapplicability to certain entities*. Except as otherwise provided in paragraph (b)(1)(iii) of this section, these regulations under section 987 do not apply to specified entities described in this paragraph (b)(1)(ii), other than specified entities that engage in transactions primarily with related persons within the meaning of section 267(b) or section 707(b) that are not themselves specified entities. For this purpose, specified entities means banks, insurance companies, leasing companies, finance coordination centers, regulated investment companies, or real estate investment trusts. Further, except as otherwise provided in paragraph (b)(1)(iii) of this section, these regulations do not apply to trusts, estates, S corporations, and partnerships other than section 987 aggregate partnerships (as defined in paragraph (b)(5) of this section).

(iii) [Reserved].

(2) *Definition of a section 987 QBU*—(i) *In general*. A section 987 QBU is an eligible QBU (as defined in paragraph (b)(3) of this section) that has a functional currency different from its direct owner. A section 987 QBU also includes the assets and liabilities of an eligible QBU that are considered under paragraph (b)(5)(ii) of this section to be a section 987 QBU of a partner in a section 987 aggregate partnership (as defined in paragraph (b)(5) of this section). A section 987 QBU will continue to be treated as a section 987 QBU of the owner until a sale or other termination of the section 987 QBU as described in § 1.987–8(b). Except as provided in paragraph (b)(2)(ii) of this section, the functional currency of an eligible QBU shall be determined under § 1.985–1.

(ii) *Section 987 QBU grouping election*—(A) *In general*. Except as provided in paragraph (b)(2)(ii)(B) of this section, an owner may elect to treat, solely for purposes of section 987, all section 987 QBUs with the same functional currency that it directly owns as a single section 987 QBU.

(B) *Special grouping rules for section 987 QBUs owned indirectly through a section 987 aggregate partnership*. An owner may elect to treat all section 987 QBUs with the same functional currency owned indirectly through a single section 987 aggregate partnership (as defined in paragraph (b)(5) of this section) as a single section 987 QBU. An owner may not treat section 987 QBUs as a single section 987 QBU if such QBUs are owned indirectly through different section 987 aggregate partnerships. Additionally, an owner may not treat section 987 QBUs that are owned both directly and indirectly through a section 987 aggregate partnership as a single section 987 QBU.

(3) *Definition of an eligible QBU*—(i) *In general*. Eligible QBU means a qualified business unit, as defined in § 1.989(a)–1, that is not subject to the Dollar Approximate Separate Transactions Method rules of § 1.985–3.

(ii) *Exclusion of certain entities*. A corporation, partnership, trust, estate, or entity disregarded as an entity separate from its owner for Federal income tax purposes as described in § 301.7701–2(c)(2) (hereafter referred to as a "DE") is not an eligible QBU (even though such an entity may have activities that qualify as an eligible QBU).

(4) *Definition of owner*. For purposes of these regulations under section 987, an owner is any person having direct or indirect ownership in an eligible QBU. Only an individual or corporation may be an owner of an eligible QBU. The term *owner* for section 987 purposes does not include an eligible QBU. For example, a section 987 QBU (QBU1) is not an owner of another section 987 QBU (QBU2) even if QBU1 owns the stock of QBU2.

(i) *Direct ownership.* An individual or a corporation is a direct owner of an eligible QBU if the individual or corporation is the owner for Federal income tax purposes of the assets and liabilities of the eligible QBU.

(ii) *Indirect ownership*. An individual or corporation that is a partner in a section 987 aggregate partnership (as defined in paragraph (b)(5) of this section) and is allocated, under § 1.987–7, all or a portion of the assets and liabilities of an eligible QBU of such partnership is an indirect owner of the eligible QBU.

(5) *Section 987 aggregate partnership*—(i) *In general*. A partnership is a section 987 aggregate partnership if:

(A) All of the interests in partnership capital and profits are owned, directly or indirectly, by persons related to each other within the meaning of sections 267(b) or 707(b). For purposes of this paragraph (b)(5), ownership of an interest in partnership capital or profits is determined in accordance with the rules for constructive ownership provided in section 267(c), other than section 267(c)(3); and

(B) The partnership has one or more eligible QBUs, at least one of which would be a section 987 QBU with respect to a partner if the partner owned the eligible QBU directly.

(ii) *Section 987 QBU of a partner*. The assets and liabilities of an eligible QBU owned through a section 987 aggregate partnership and allocated to a partner under the principles of § 1.987–7(b) are considered to be a section 987 QBU of such partner if the partner has a functional currency different from that of the eligible QBU.

(iii) *Certain unrelated partners disregarded*. In determining whether a partnership is a section 987 aggregate partnership, the interest of an unrelated partner shall be disregarded if the acquisition of such interest has as a principal purpose the avoidance of this paragraph (b)(5).

(6) [Reserved].

(7) *Examples illustrating paragraph (b) of this section*. The following examples illustrate the principles of paragraph (b) of this section. U.S. Corp is a domestic corporation, has the U.S. dollar as its functional currency, and uses the calendar year as its taxable year. Except as otherwise provided, (i) Business A and Business B are eligible QBUs and have the euro and the Japanese yen, respectively, as their functional currencies and (ii) DE1 and DE2 are DEs, have no assets or liabilities, and conduct no activities.

Example 1. (i) *Facts*. U.S. Corp owns Business A and all of the interests in DE1. DE1 maintains a separate set of books and records that are kept in British pounds. DE1 owns pounds and all of the stock of a foreign corporation, FC. DE1 is liable to a lender on a pound-denominated obligation that was incurred to acquire the stock of FC. The FC stock, the pounds, and the liability incurred to acquire the FC stock are recorded on DE1's separate books and records. DE1 has no other assets or liabilities and conducts no activities (other than holding the FC stock and servicing its liability).

(ii) *Analysis*. (A) Pursuant to paragraph (b)(4)(i) of this section, U.S. Corp is the direct owner of Business A because it is the owner of the assets and liabilities of Business A. Because Business A is an eligible QBU with a functional currency that is different from the functional currency of its owner, U.S. Corp, Business A is a section 987 QBU (as defined in paragraph (b)(2) of this section). As a result, U.S. Corp and its section 987 QBU, Business A, are subject to section 987.

(B) Holding the stock of FC and pounds and servicing a liability does not constitute a trade or business within the meaning of § 1.989(a)–1(c). Because the activities of DE1 do not constitute a trade or business within the meaning of § 1.989(a)–1(c), such activities are not an eligible QBU. In addition, pursuant to paragraph (b)(3)(ii) of this section, DE1 itself is not an eligible QBU. As a result, neither DE1 nor its activities qualify as a section 987 QBU of U.S. Corp. Therefore, neither the activities of DE1 nor DE1 itself is subject to section 987. For the foreign currency treatment of payments on DE1's pound-denominated liability, see § 1.988–2(b).

Example 2. (i) *Facts*. U.S. Corp owns all of the interests in DE1. DE1 owns Business A and all of the interests in DE2. The only activities of DE1 are Business A activities and holding the interests in DE2. DE2 owns Business B and Business

C. For purposes of this example, Business B does not maintain books and records that are separate from its owner, DE2. Instead, the activities of Business B are reflected on the books and records of DE2, which are maintained in Japanese yen. In addition, Business C has the U.S. dollar as its functional currency, maintains books and records that are separate from the books and records of DE2, and is an eligible QBU.

(ii) *Analysis*. (A) Pursuant to paragraph (b)(3)(ii) of this section, DE1 and DE2 are not eligible QBUs. Pursuant to paragraph (b)(3)(i) of this section, the Business B and Business C activities of DE2, and the Business A activities of DE1, are eligible QBUs. Moreover, pursuant to paragraph (b)(4) of this section, DE1 is not the owner of the Business A, Business B, or Business C eligible QBUs, and DE2 is not the owner of the Business B or Business C eligible QBUs. Instead, pursuant to paragraph (b)(4)(i) of this section, U.S. Corp is the direct owner of the Business A, Business B, and Business C eligible QBUs.

(B) Because Business A and Business B are eligible QBUs with functional currencies that are different than the functional currency of U.S. Corp, Business A and Business B are section 987 QBUs (as defined in paragraph (b)(2) of this section).

(C) The Business C eligible QBU has the same functional currency as U.S. Corp. Therefore, the Business C eligible QBU is not a section 987 QBU.

Example 3. (i) *Facts*. U.S. Corp owns all of the interests in DE1. DE1 owns Business A and Business B. For purposes of this example, assume Business B has the euro as its functional currency.

(ii) *Analysis*. (A) Pursuant to paragraph (b)(3)(ii) of this section, DE1 is not an eligible QBU. Moreover, pursuant to paragraph (b)(4) of this section, DE1 is not the owner of the Business A or Business B eligible QBUs. Instead, pursuant to paragraph (b)(4)(i) of this section, U.S. Corp is the direct owner of the Business A and Business B eligible QBUs.

(B) Business A and Business B constitute two separate eligible QBUs, each with the euro as its functional currency. Accordingly, Business A and Business B are section 987 QBUs of U.S. Corp. U.S. Corp may elect to treat Business A and Business B as a single section 987 QBU pursuant to paragraph (b)(2)(ii)(A) of this section. If such election is made, pursuant to paragraph (b)(4)(i) of this section, U.S. Corp would be the direct owner of the Business AB section 987 QBU that would include the activities of both the Business A section 987 QBU and the Business B section 987 QBU. In addition, pursuant to paragraph (b)(4) of this section, DE1 would not be treated as the owner of the Business AB section 987 QBU.

Example 4. (i) *Facts*. U.S. Corp owns all the stock of Y, a U.S. corporation that is a member of U.S. Corp's consolidated group. U.S. Corp also owns all the stock of CFC, a controlled foreign corporation (as defined in section 957(a)) of U.S. Corp

with the Japanese yen as its functional currency. Y and CFC are the only partners in P, a foreign partnership. P owns DE1 and Business A. DE1 owns Business B.

(ii) *Analysis*. (A) Under paragraph (b)(5)(i) of this section, P is a section 987 aggregate partnership because Y and CFC own all the interests in partnership capital and profits, Y and CFC are related within the meaning of section 267(b), and the requirements of § 1.987–1(b)(5)(i)(B) are satisfied. Pursuant to paragraph (b)(3)(ii) of this section, P and DE1 are not eligible QBUs. Moreover, pursuant to paragraph (b)(4) of this section, for purposes of section 987, neither P nor DE1 is the owner of the Business B eligible QBU, and P is not the owner of the Business A eligible QBU. Instead, pursuant to paragraph (b)(4)(ii) of this section, Y and CFC are indirect owners of the Business A eligible QBU and the Business B eligible QBU to the extent they are allocated the assets and liabilities of such businesses under § 1.987–7.

(B) Because Business A and Business B are eligible QBUs with different functional currencies than Y, the portions of Business A and Business B allocated to Y under § 1.987–7 are section 987 QBUs of Y.

(C) Because the Business A eligible QBU has a different functional currency than CFC, the portion of Business A that is allocated to CFC under § 1.987–7 is a section 987 QBU, and CFC and its section 987 QBU are subject to section 987. Because the Business B eligible QBU has the same functional currency as CFC, the portion of Business B that is allocated to CFC under § 1.987–7 is not a section 987 QBU of CFC.

Example 5. (i) *Facts*. U.S. Corp owns all of the interests in DE1. DE1 owns Business A and all of the interests in DE2. DE2 owns Business B and all of the interests in DE3, an entity disregarded as an entity separate from its owner. DE3 owns Business C, which is an eligible QBU with the Russian ruble as its functional currency.

(ii) *Analysis*. Pursuant to paragraph (b)(3)(ii) of this section, DE1, DE2, and DE3 are not eligible QBUs, and the Business A, Business B, and Business C activities are eligible QBUs. Pursuant to paragraph (b)(4) of this section, an eligible QBU is not an owner of another eligible QBU. Accordingly, the Business A eligible QBU is not the owner of the Business B eligible QBU, and the Business B eligible QBU is not the owner of the Business C eligible QBU. Instead, pursuant to paragraph (b)(4) of this section, U.S. Corp is the direct owner of the Business A, Business B, and Business C eligible QBUs. Because each of the Business A, Business B, and Business C eligible QBUs has a different functional currency than U.S. Corp, such eligible QBUs are section 987 QBUs of U.S. Corp.

(c) *Exchange rates*. Solely for purposes of section 987, the following definitions shall apply.

(1) *Spot rate*—(i) *In general*. Except as otherwise provided in this section, the spot rate means the rate determined under the principles of § 1.988–1(d)(1), (2), and (4) on the relevant date.

(ii) *Election to use a spot rate convention*—(A) *In general—spot rate convention*. An owner may elect to use a spot rate convention that reasonably approximates the spot rate determined in paragraph (c)(1)(i) of this section in lieu of such spot rate. A spot rate convention may be determined with respect to a spot rate at the beginning of a reasonable period, the end of a reasonable period, as an average of spot rates for a reasonable period, or by reference to spot and forward rates for a reasonable period. For this purpose, a reasonable period shall not exceed three months. For example, in lieu of the spot rate determined in paragraph (c)(1)(i) of this section, the spot rate for all transactions during a monthly period can be determined pursuant to one of the following conventions: the spot rate at the beginning of the current month or at the end of the preceding month; the monthly average of daily spot rates for the current or preceding month; or an average of the beginning and ending spot rates for the current or preceding month. Similarly, in lieu of the spot rate determined in paragraph (c)(1)(i) of this section, the spot rate can be determined pursuant to an average of the spot rate and the 30-day forward rate on a day of the preceding month. Use of a spot rate convention that is consistent with the convention used for financial accounting purposes is presumed to reasonably approximate the rate in paragraph (c)(1)(i) of this section. The Commissioner can rebut this presumption if the Commissioner determines that the use of the convention would not clearly reflect income based on the facts and circumstances available at the time of the election.

(B) [Reserved].

(iii) *Election to use spot rates in lieu of yearly average exchange rates*. A taxpayer may elect under this paragraph (c)(1)(iii) to use spot rates in lieu of yearly average exchange rates (as defined in paragraph (c)(2) of this section) for certain purposes. In particular, a taxpayer that makes this election must use the spot rate for purposes of determining the historic rate, as provided in paragraph (c)(3)(ii) of this section, and for purposes of translating items of income, gain, deduction, or loss of a section 987 QBU into the owner's functional currency, as described in § 1.987–3(c)(1). Additionally, a taxpayer that makes this election will be deemed also to elect to use the historic inventory method described in § 1.987–3(c)(2)(iv)(B).

(2) *Yearly average exchange rate*. For purposes of section 987, the yearly average exchange rate is a rate that represents an average exchange rate for the taxable year (or, if the relevant period is less than a full taxable year, such portion of the taxable year) computed under any reasonable method. For example, an owner may determine the yearly average exchange rate based on a daily, monthly or quarterly averaging convention, whether weighted or unweighted, and may take into account forward rates for a period not to exceed three months. Use of an averaging convention that is consistent with the convention used for financial accounting purposes is presumed to be a reasonable method. The Commissioner can rebut this presumption if the Commissioner determines that

the use of the convention would not have been expected to clearly reflect income based on the facts and circumstances available at the time of the election.

(3) *Historic rate*—(i) *In general*. Except as otherwise provided in these regulations, the historic rate is determined as described in paragraphs (c)(3)(i)(A) through (E) of this section.

(A) *Assets generally*. In the case of an asset other than inventory that is acquired by a section 987 QBU (including through a transfer), the historic rate is the yearly average exchange rate applicable to the year of acquisition.

(B) *Inventory under the simplified inventory method*. In the case of inventory with respect to which a taxpayer uses the simplified inventory method described in § 1.987–3(c)(2)(iv)(A), the historic rate for inventory accounted for under the last-in, first-out (LIFO) method of accounting is the yearly average exchange rate applicable to the year in which the inventory's LIFO layer arose. The historic rate for all other inventory of such a taxpayer is the yearly average exchange rate for the taxable year for which the determination of the historic rate for such inventory is relevant.

(C) *Inventory under the historic inventory method*. In the case of inventory with respect to which a taxpayer has elected under § 1.987– 3(c)(2)(iv)(B) to use the historic inventory method, each inventoriable cost with respect to such inventory may have a different historic rate. The historic rate for each inventoriable cost is the exchange rate at which such item would be translated under § 1.987–3 if it were not an inventoriable cost.

(D) *Liabilities generally*. In the case of a liability that is incurred or assumed by a section 987 QBU, the historic rate is the yearly average exchange rate applicable to the year the liability is incurred or assumed.

(E) [Reserved].

(ii) *Historic rate when an election to use spot rates in lieu of yearly average exchange rates is in effect*. A taxpayer that has elected under paragraph (c)(1)(iii) of this section to use spot rates in lieu of yearly average exchange rates must determine historic rates under paragraphs (c)(3)(i)(A) and (c)(3)(i)(D) of this section using the spot rate (as defined in paragraph (c)(1) of this section) for the date an asset is acquired by a section 987 QBU or a liability is assumed or incurred by a section 987 QBU in lieu of using the yearly average exchange rate.

(iii) *Date placed in service for depreciable or amortizable property*. In the case of depreciable or amortizable property, an owner may determine the historic rate (whether a yearly average exchange rate or a spot rate, as applicable) by reference to the date such property is placed in service by the section 987 QBU rather than the date the property was acquired, provided that this convention is consistently applied for all such property attributable to that section 987 QBU.

(iv) *Changed functional currency*. In the case of a section 987 QBU or an owner of a section 987 QBU that previously changed its functional currency, § 1.985–5(d)(1)(ii)(A) and § 1.985–5(e)(4)(i)(A), respectively, shall be taken into account in determining the historic rate for an item reflected on the balance sheet of the section 987 QBU immediately prior to the year of change.

(d) *Marked item*. A marked item is an asset (marked asset) or liability (marked liability) that is properly reflected on the books and records of a section 987 QBU under § 1.987–2(b) and that—

(1) Is denominated in, or determined by reference to, the functional currency of the section 987 QBU, is not a section 988 transaction of the section 987 QBU, and would be a section 988 transaction if such item were held or entered into directly by the owner of the section 987 QBU;

(2) Is a prepaid expense or a liability for an advance payment of unearned income, in either case having an original term of one year or less on the date the prepaid expense or liability for an advance payment of unearned income arises; or

(3) [Reserved].

(e) *Historic item*. A historic item is an asset (historic asset) or liability (historic liability) that is properly reflected on the books and records of a section 987 QBU under § 1.987–2(b) and that is not a marked item (as defined in paragraph (d) of this section).

(f) [Reserved].

(g) *Elections*—(1) *In general*. This paragraph (g) provides rules for making elections under section 987. Except as otherwise provided in paragraph (g)(2) of this section, such elections—

(i) May be made separately for each section 987 QBU;

(ii) Are made by the owner of the section 987 QBU (as defined in paragraph (b)(4) of this section); and

(iii) Must be made for the first taxable year in which the election is relevant in determining the section 987 taxable income or loss, or section 987 gain or loss, of the section 987 QBU and in which the regulations implementing the election are applicable with respect to the section 987 QBU.

(2) *Exceptions to the general rules*—(i) *Consistency and timeliness requirements for certain elections*. Notwithstanding paragraph (g)(1)(i) of this section, the following consistency and timeliness requirements apply:

(A) *Section 987 grouping election*. Elections made pursuant to paragraph (b)(2)(ii) of this section (regarding the grouping of section 987 QBUs) are binding on all section 987 QBUs that are eligible to be grouped under the particular election (for example, election to group all euro QBUs owned by the same aggregate partnership), regardless of whether the section 987 QBU is

established or acquired after the election is made and regardless of whether the section 987 QBU is identified on the election as required in paragraph (g)(3)(i)(A) of this section.

(B) [Reserved].

(ii) *Persons making elections for QBUs owned by foreign corporations*. Notwithstanding paragraph (g)(1)(ii) of this section, if a section 987 QBU is owned by a foreign corporation, elections shall be made in accordance with § 1.964–1(c) by the foreign corporation's controlling domestic shareholders, as defined under § 1.964–1(c)(5)(i) (dealing with controlled foreign corporations) and § 1.964–1(c)(5)(ii) (dealing with noncontrolled section 902 corporations).

(3) *Manner of making elections*—(i) *Election made by attaching statement to a return*. Except as provided in paragraph (g)(3)(ii) of this section, elections shall be made under section 987 for each section 987 QBU by attaching a statement with the information required in this paragraph (g)(3)(i) to the timely filed tax return of the owner or, in the case of a foreign corporation, other applicable person for the first taxable year in which the election is required to be made under paragraph (g)(1)(iii) of this section.

(A) *Section 987 grouping election*. The election provided in paragraph (b)(2)(ii) of this section must be titled "Section 987 Grouping Election Under § 1.987–1(b)(2)(ii)" and provide the following information:

(*1*) The name, address, and functional currency of each section 987 QBU that the taxpayer is grouping together; and

(*2*) The owner's name and address.

(B) *Election to use a spot rate convention*. An election under paragraph (c)(1)(ii) of this section to use a spot rate convention must be titled "Section 987 Election to Use a Spot Rate Convention Under § 1.987–1(c)(1)(ii)" and provide the following information:

(*1*) A description of the convention; and

(*2*) The name and address of each section 987 QBU for which the election is being made.

(C) *Election to use spot rates in lieu of yearly average exchange rates*. An election under paragraph (c)(1)(iii) of this section to use spot rates in lieu of yearly average exchange rates must be titled "Section 987 Election to Use Spot Rates in Lieu of Yearly Average Exchange Rates Under § 1.987–1(c)(1)(iii)" and provide the following information:

(*1*) A description of the convention; and

(*2*) The name and address of each section 987 QBU for which the election is being made.

(D) *Election to use the historic inventory method*. An election under § 1.987–3(c)(2)(iv)(B) to use the historic inventory method shall be titled "Section 987 Election to Use the Historic Inventory Method Under § 1.987–3(c)(2)(iv)(B)" and must provide the name and address of each section 987 QBU for which the election is being made.

(ii) *Election made by filing a dedicated section 987 form*. If the Commissioner publishes a form that provides the manner in which elections are made under section 987, the form shall govern the manner in which elections are made under section 987.

(4) *No change in method of accounting*. An election under section 987 is not governed by the general rules concerning changes in methods of accounting. See also paragraph (g)(5) of this section.

(5) *Revocation of an election*. Elections under section 987 may not be revoked without the consent of the Commissioner or his delegate. The Commissioner or his delegate will consider allowing a revocation of an election if the taxpayer can demonstrate significantly changed circumstances or such other circumstances that clearly demonstrate a substantial non-tax business reason for revoking the election.

§ 1.987–2 Attribution of items to eligible QBUs; definition of a transfer and related rules.

(a) *Scope and general principles*. Paragraph (b) of this section provides rules for attributing assets and liabilities, and items of income, gain, deduction, and loss, to an eligible QBU. Assets and liabilities are attributed to a section 987 QBU for purposes of section 987. Items of income, gain, deduction, and loss are attributed to a section 987 QBU for purposes of computing the section 987 taxable income of the section 987 QBU and of its owner. Paragraph (c) of this section defines a transfer to or from a section 987 QBU. Paragraph (d) of this section provides translation rules for transfers to a section 987 QBU.

(b) *Attribution of items to an eligible QBU*—(1) *General rules*. Except as provided in paragraphs (b)(2) and (3) of this section, items are attributable to an eligible QBU to the extent they are reflected on the separate set of books and records, as defined in § 1.989(a)–1(d), of the eligible QBU. In the case of a section 987 aggregate partnership, items reflected on the books and records of the partnership and deemed allocated to an eligible QBU of such partnership are considered to be reflected on the books and records of such eligible QBU. For purposes of this section, the term "item" refers to any asset or liability, and any item of income, gain, deduction, or loss. Items that are attributed to an eligible QBU pursuant to this section must be adjusted to conform to Federal income tax principles. Except as provided in § 1.989(a)–1(d)(3), these attribution rules apply solely for purposes of section 987. For example, the allocation and apportionment of interest expense under section 864(e) is independent of the rules under section 987.

(2) *Exceptions for non-portfolio stock, interests in partnerships, and certain acquisition indebtedness*. The following items shall not be considered to be on the books and records of an eligible QBU:

(i) Stock of a corporation (whether domestic or foreign), other than stock of a corporation reflected on the books and records (within the meaning of paragraph (b)(1) of this section) of an eligible QBU if the owner of the eligible QBU owns less than 10 percent of the total value of all classes of stock of such corporation. For this purpose, section 318(a) applies in determining ownership, except that in applying section 318(a)(2)(C), the phrase "10 percent" is used instead of the phrase "50 percent."

(ii) An interest in a partnership (whether domestic or foreign).

(iii) A liability that was incurred to acquire stock described in paragraph (b)(2)(i) of this section or that was incurred to acquire a partnership interest described in paragraph (b)(2)(ii) of this section.

(iv) Income, gain, deduction, or loss arising from the items described in paragraphs (b)(2)(i) through (iii) of this section. For example, a section 951 inclusion with respect to stock of a foreign corporation described in paragraph (b)(2)(i) of this section shall not be considered to be on the books and records of an eligible QBU.

(3) *Adjustments to items reflected on the books and records*—(i) *General rule*. If a principal purpose of recording (or failing to record) an item on the books and records of an eligible QBU is the avoidance of Federal income tax under, or through the use of, section 987, the item must be allocated between or among the eligible QBU, the owner of such eligible QBU, and any other persons, entities (including DEs), or other QBUs within the meaning of § 1.989(a)–1(b) (including eligible QBUs) in a manner that reflects the substance of the transaction. For purposes of this paragraph (b)(3)(i), relevant factors for determining whether such Federal income tax avoidance is a principal purpose of recording (or failing to record) an item on the books and records of an eligible QBU shall include, but are not limited to, the factors set forth in paragraphs (b)(3)(ii) and (iii) of this section. The presence or absence of any factor or factors is not determinative. Moreover, the weight given to any factor (whether or not set forth in paragraphs (b)(3)(ii) and (iii) of this section) depends on the particular case.

(ii) *Factors indicating no tax avoidance*. For purposes of paragraph (b)(3)(i) of this section, factors that may indicate that recording (or failing to record) an item on the books and records of an eligible QBU did not have as a principal purpose the avoidance of Federal income tax under, or through the use of, section 987 include the recording (or not recording) of an item:

(A) For a significant and bona fide business purpose;

(B) In a manner that is consistent with the economics of the underlying transaction;

(C) In accordance with generally accepted accounting principles (or similar comprehensive accounting standard);

(D) In a manner that is consistent with the treatment of similar items from year to year;

(E) In accordance with accepted conditions or practices in the particular trade or business of the eligible QBU;

(F) In a manner that is consistent with an explanation of existing internal accounting policies that is evidenced by documentation contemporaneous with the timely filing of a Federal income tax return for the taxable year; and

(G) As a result of a transaction between legal entities (for example, the transfer of an asset or the assumption of a liability), even if such transaction is not regarded for Federal income tax purposes (for example, a transaction between a DE and its owner).

(iii) *Factors indicating tax avoidance*. For purposes of paragraph (b)(3)(i) of this section, factors that may indicate that a principal purpose of recording (or failing to record) an item on the books and records of an eligible QBU is the avoidance of Federal income tax under, or through the use of, section 987 include:

(A) The presence or absence of an item on the books and records that is the result of one or more transactions that are transitory, for example, due to a circular flow of cash or other property;

(B) The presence or absence of an item on the books and records that is the result of one or more transactions that do not have substance;

(C) The presence or absence of an item on the books and records that results in the taxpayer (or a person related to the taxpayer within the meaning of section 267(b) or section 707(b)) having offsetting positions with respect to the functional currency of a section 987 QBU; and

(D) The absence of any or all of the factors listed in paragraph (b)(3)(ii) of this section.

(4) *Assets and liabilities of a section 987 aggregate partnership or DE that are not attributed to an eligible QBU*. Neither a section 987 aggregate partnership nor a DE is an eligible QBU and, thus, neither entity can be a section 987 QBU. See § 1.987–1(b)(2) and (3). As a result, a section 987 aggregate partnership or DE may own assets and liabilities that are not attributed to an eligible QBU as provided under this paragraph (b) and, therefore, are not subject to section 987. For the foreign currency treatment of such assets or liabilities, see § 1.988–1(a)(4).

(c) *Transfers to and from section 987 QBUs*—(1) *In general*. The following rules apply for purposes of determining whether there is a transfer of an asset or a liability from an owner to a section 987 QBU, or from a section 987 QBU to an owner. These rules apply solely for purposes of section 987.

(2) *Disregarded transactions*—(i) *General rule*. An asset or liability shall be treated as transferred to a section 987 QBU from its owner (whether direct owner or indirect owner, as defined in § 1.987–1(b)(4)) if, as a result of a disregarded transaction (as defined in paragraph (c)(2)(ii) of this section), such asset or liability is reflected on the books and records of the section 987 QBU within the meaning of paragraph (b) of this section. Similarly, an asset or liability shall be treated as transferred from a section 987 QBU to its owner if, as a result of a disregarded transaction, such asset or liability is no longer reflected on the books and records of the section 987 QBU within the meaning of paragraph (b) of this section.

(ii) *Definition of a disregarded transaction*. For purposes of this section, a disregarded transaction means a transaction that is not regarded for Federal income tax purposes (for example, any transaction between separate section 987 QBUs of the same owner). For purposes of this paragraph (c), a disregarded transaction shall be treated as including the recording of an asset or liability on the books and records of an eligible QBU (as defined in § 1.987–1(b)(3)) of an owner, if the recording is the result of such asset or liability being removed from the books and records of a separate eligible QBU of the same owner, whether such separate eligible QBU is owned directly or is owned indirectly through the same entity (including through a DE or a section 987 aggregate partnership). Additionally, if an asset or liability that is attributable to a section 987 QBU within the meaning of paragraph (b) of this section is sold or exchanged (including in a nonrecognition transaction, such as an exchange under section 351) for an asset or liability that is not attributable to the section 987 QBU immediately after the sale or exchange, the sold or exchanged asset or liability that was attributable to the section 987 QBU immediately before the transaction shall be treated as transferred from the section 987 QBU to its direct or indirect owner in a disregarded transaction immediately before the sale or exchange for purposes of section 987 (including for purposes of recognizing section 987 gain or loss under § 1.987–5) and subsequently sold or exchanged by the owner. The preceding sentence shall not apply with respect to an acquisition or disposition of an interest in a section 987 aggregate partnership or in a DE, as described in paragraph (c)(5) of this section.

(iii) *Items derived from disregarded transactions ignored*. For purposes of section 987, disregarded transactions shall not give rise to items of income, gain, deduction, or loss that are taken into account in determining section 987 taxable income or loss under § 1.987–3.

(3) *Transfers of assets to and from section 987 QBUs owned through section 987 aggregate partnerships*—(i) *Contributions to section 987 aggregate partnerships*. Solely for purposes of section 987, an asset shall be treated as transferred by an indirect owner (as defined in § 1.987–1(b)(4)(ii)) to a section 987 QBU of a partner (as defined in § 1.987–1(b)(5)(ii)) to the extent the indirect owner contributes the asset to the section 987 aggregate partnership that carries on the activities of the section 987 QBU, provided that, immediately prior to the contribution, the asset is not reflected on the books and records of the section

987 QBU within the meaning of paragraph (b) of this section and the asset is reflected on the books and records of the section 987 QBU immediately following such contribution. For purposes of this paragraph (c)(3)(i), deemed contributions of money described under section 752 shall be disregarded. See paragraph (c)(4)(ii) of this section for rules governing the assumption by a partner of liabilities of a section 987 aggregate partnership.

(ii) *Distributions from section 987 aggregate partnerships.* Solely for purposes of section 987, an asset shall be treated as transferred from a section 987 QBU of a partner to its indirect owner to the extent the section 987 aggregate partnership that carries on the activities of the section 987 QBU distributes the asset to the indirect owner, provided that, immediately prior to such distribution, the asset is reflected on the books and records of the section 987 QBU within the meaning of paragraph (b) of this section, and the asset is not reflected on the books and records of the section 987 QBU immediately after such distribution. For purposes of this paragraph (c)(3)(ii), deemed distributions of money described under section 752 shall be disregarded. See paragraph (c)(4)(i) of this section for rules governing the assumption by a section 987 aggregate partnership of liabilities of a partner.

(4) *Transfers of liabilities to and from section 987 QBUs owned through section 987 aggregate partnerships*—(i) *Assumptions of partner liabilities*. Solely for purposes of section 987, a liability of the owner of a section 987 aggregate partnership shall be treated as transferred to a section 987 QBU of a partner if, and to the extent, the section 987 aggregate partnership assumes such liability, provided that, immediately prior to the transfer, the liability is not reflected on the books and records of the section 987 QBU within the meaning of paragraph (b) of this section, and the liability is reflected on the books and records of the section 987 QBU immediately following the transfer.

(ii) *Assumptions of section 987 aggregate partnership liabilities*. Solely for purposes of section 987, a liability of a section 987 aggregate partnership shall be treated as transferred from a section 987 QBU of a partner to its indirect owner if, and to the extent, the indirect owner assumes such liability of the section 987 aggregate partnership, provided that, immediately prior to such assumption, the liability is reflected on the books and records of the section 987 QBU within the meaning of paragraph (b) of this section, and the liability is not reflected on the books and records of the section 987 QBU immediately following the transfer.

(5) *Acquisitions and dispositions of interests in DEs and section 987 aggregate partnerships*. Solely for purposes of section 987, an asset or liability shall be treated as transferred to a section 987 QBU from its owner if, as a result of an acquisition (including by contribution) or disposition of an interest in a section 987 aggregate partnership or DE, such asset or liability is reflected on the books and records of the section 987 QBU. Similarly, an asset or liability shall be treated as transferred from a section 987 QBU to its owner if, as a result of an

acquisition or disposition of an interest in a section 987 aggregate partnership or DE, the asset or liability is not reflected on the books and records of the section 987 QBU.

(6) *Changes in form of ownership*. For purposes of this paragraph (c), mere changes in the form of ownership of an eligible QBU shall not result in a transfer to or from a section 987 QBU. Instead, the determination of whether a transfer has occurred in such case shall be made under paragraph (c)(5) of this section. For example, a transaction that causes a direct owner of an eligible QBU to become an indirect owner of the eligible QBU shall not, except to the extent provided in paragraph (c)(5) of this section, result in a transfer to or from a section 987 QBU. See, for example, Rev. Rul. 99–5 (1999–1 CB 434), Rev. Rul. 99–6 (1999–1 CB 432), § 601.601(d)(2) of this chapter, and section 708 and the applicable regulations.

(7) *Application of general tax law principles*. General tax law principles, including the circular cash flow, step-transaction, economic substance, and substance-over-form doctrines, apply for purposes of determining whether there is a transfer of an asset or liability under this paragraph (c), including a transfer of an asset or liability pursuant to a disregarded transaction (as defined in paragraph (c)(2)(ii) of this section).

(8) *Interaction with § 1.988–1(a)(10)*. See § 1.988–1(a)(10) for rules regarding the treatment of an intra-taxpayer transfer of a section 988 transaction.

(9) [Reserved].

(10) *Examples*. The following examples illustrate the principles of this paragraph (c). For purposes of the examples, X and Y are domestic corporations, have the U.S. dollar as their functional currency, and use the calendar year as their taxable years. Furthermore, except as otherwise provided, Business A and Business B are eligible QBUs that have the euro and the Japanese yen, respectively, as their functional currencies, and DE1 and DE2 are DEs. For purposes of determining whether any of the transfers in these examples result in remittances, see § 1.987–5.

Example 1. *Transfer to a directly owned section 987 QBU*. (i) *Facts*. X owns all of the interests in DE1. DE1 owns Business A, which is a section 987 QBU of X. X owns €100 that are not reflected on the books and records of Business A. Business A is in need of additional capital and, as a result, X lends the €100 to DE1 for use in Business A in exchange for a note.

(ii) *Analysis*. (A) The loan from X to DE1 is not regarded for Federal income tax purposes (because it is an interbranch transaction) and therefore is a disregarded transaction (as defined in paragraph (c)(2)(ii) of this section). As a result, the DE1 note held by X and the liability of DE1 under the note are not taken into account under this section.

(B) As a result of the disregarded transaction, the €100 is reflected on the books and records of Business A. Therefore, X is treated as transferring €100 to its Business A section 987 QBU for purposes of section 987. This transfer is taken

into account in determining the amount of any remittance for the taxable year under § 1.987–5(c). See § 1.988–1(a)(10)(ii) for the application of section 988 to X as a result of the transfer of non-functional currency to its section 987 QBU.

Example 2. *Transfer to a directly owned section 987 QBU*. (i) *Facts*. X owns Business A and Business B, both of which are section 987 QBUs of X. X owns equipment that is used in Business A and is reflected on the books and records of Business A. Because Business A has excess manufacturing capacity and X intends to expand the manufacturing capacity of Business B, the equipment formerly used in Business A is transferred to Business B for use by Business B. As a result of the transfer, the equipment is removed from the books and records of Business A and is recorded on the books and records of Business B.

(ii) *Analysis*. The transfer of the equipment from the books and records of Business A to the books and records of Business B is not regarded for Federal income tax purposes (because it is an interbranch transaction), and therefore it is a disregarded transaction for purposes of this paragraph (c). Therefore, for purposes of section 987, the Business A section 987 QBU is treated as transferring the equipment to X, and X is subsequently treated as transferring the equipment to the Business B section 987 QBU. These transfers are taken into account in determining the amount of any remittance for the taxable year under § 1.987–5(c).

Example 3. *Intracompany sale of property between two section 987 QBUs*. (i) *Facts*. X owns all of the interests in DE1 and DE2. DE1 and DE2 own Business A and Business B, respectively, both of which are section 987 QBUs of X. DE1 owns equipment that is used in Business A and is reflected on the books and records of Business A. For business reasons, DE1 sells a portion of the equipment used in Business A to DE2 in exchange for a fair market value amount of Japanese yen. The yen used by DE2 to acquire the equipment was generated by Business B and was reflected on Business B's books and records. Following the sale, the yen and the equipment will be used in Business A and Business B, respectively. As a result of such sale, the equipment is removed from the books and records of Business A and is recorded on the books and records of Business B. Similarly, as a result of the sale, the yen is removed from the books and records of Business B and is recorded on the books and records of Business A.

(ii) *Analysis*. (A) The sale of equipment between DE1 and DE2 is a transaction that is not regarded for Federal income tax purposes (because it is an interbranch transaction). Therefore the transaction is a disregarded transaction for purposes of paragraph (c) of this section. As a result, the sale is not taken into account under this section and, pursuant to paragraph (c)(2)(iii) of this section, the sale does not give rise to an item of income, gain, deduction, or loss for purposes of determining section 987 taxable income or loss under § 1.987–3. However, the yen and equipment exchanged by DE1 and DE2 in connection with the sale must be taken into account as a disregarded transaction under this paragraph (c).

(B) As a result of the disregarded transaction, the equipment ceases to be reflected on the books and records of Business A and becomes reflected on the books and records of Business B. Therefore, the Business A section 987 QBU is treated as transferring the equipment to X, and X is subsequently treated as transferring such equipment to the Business B section 987 QBU.

(C) Additionally, as a result of the disregarded transaction, the yen currency ceases to be reflected on the books and records of Business B and becomes reflected on the books and records of Business A. Therefore, the Business B section 987 QBU is treated as transferring the yen to X, and X is subsequently treated as transferring such yen from X to the Business A section 987 QBU. The transfers among Business A, Business B and X are taken into account in determining the amount of any remittance for the taxable year under § 1.987–5(c).

Example 4. Sale of property by a section 987 QBU to a corporation that is a member of the consolidated group. (i) *Facts*. X owns all of the stock of Y and all of the interests in DE1. DE1 owns Business A. X and Y file a consolidated return. Business A sells property to Y for €100.

(ii) *Analysis*. The sale of property by Business A to Y is not considered a transfer of property to X (and a corresponding transfer from X to Y) under paragraph (c) of this section because the transaction is regarded for Federal income tax purposes. Rather, for purposes of section 987, the transaction is considered to occur between Business A and Y.

Example 5. T*ransactions of a section 987 QBU owned through an aggregate partnership*. (i) *Facts*. (A) X owns all of the stock of Y and a 50 percent interest in the capital and profits of P, a partnership. Y owns the other 50 percent interest in P. P owns 100 percent of the interests in DE1 and DE2. DE1 owns Business A and DE2 owns Business B.

(B) In connection with Business A, DE1 licenses intangible property to both DE2 and X. X enters into the license agreement in a transaction other than in its capacity as a partner of P and, therefore, the license is considered as occurring between P and one who is not a partner within the meaning of section 707(a). X uses the intangible property in its own trade or business in the U.S. DE2 uses the intangible property in Business B. Pursuant to the license agreement, X and DE2 pay a €30 and a €50 royalty, respectively, to DE1.

(ii) *Analysis*. (A) Under § 1.987–1(b)(5)(i), P is a section 987 aggregate partnership because X and Y own all the interests in partnership capital and profits, X and Y are related within the meaning of section 267(b), and the requirements of § 1.987–1(b)(5)(i)(B) are satisfied. X and Y each have a 50 percent allocable share of the assets and liabilities of Business A and Business B, as determined under § 1.987–7. Under § 1.987–1(b)(5)(ii), the assets and liabilities of Business A allocated to X are a section 987 QBU of X, and the assets and liabilities of Business A allocated to Y are a section 987 QBU of Y. Likewise, the assets and liabilities of Business B allocated to X are a section 987 QBU of X, and the assets and liabilities of Business B allocated to Y are a section 987 QBU of Y.

(B) The license from DE1 to DE2 is not regarded for Federal income tax purposes (because it is an interbranch agreement) and, as a result, royalty payments under the license are disregarded transactions. Thus, pursuant to paragraph (c)(2)(iii) of this section, DE1's receipt of the royalty pursuant to the license agreement does not give rise to an item of income, gain, deduction, or loss for purposes of determining section 987 taxable income or loss under § 1.987–3. However, the €50 that is paid from DE2 to DE1 pursuant to the license agreement must be taken into account under paragraph (c) of this section. Accordingly, €50 ceases to be reflected on the books and records of Business B and becomes reflected on the books and records of Business A. As a result, a 50 percent allocable share of the €50 royalty payment (€25) is treated as transferred from each of the Business B section 987 QBUs of X and Y, to X and Y, respectively. And subsequently, X and Y are treated as transferring their respective receipts of €25 to their respective Business A section 987 QBUs. These transfers are taken into account in determining the amount of any remittance to either of X or Y for the taxable year under § 1.987–5(c).

(C) The €30 royalty payment from X to DE1 is regarded for Federal income tax purposes (because it is a payment from a partnership to a separate entity). Accordingly, the royalty payment is not a disregarded transaction for purposes of this paragraph (c) and is therefore not treated as a transfer of an asset from an owner to a section 987 QBU. As a result, the payment is not taken into account in determining the amount of any remittance for the taxable year under § 1.987–5(c). Instead, the payment gives rise to an item of income and deduction that must be taken into account in computing section 987 taxable income or loss of Business A pursuant to § 1.987–3.

Example 6. *Acquisition of an interest in a partnership*. (i) *Facts*. (A) X owns all of the stock of Z, a domestic corporation with the dollar as its functional currency. X also owns all of the stock of Y and a 50 percent interest in the capital and profits of P, a partnership. Y owns the other 50 percent interest in P. P owns Business A, and P owns no other assets or liabilities other than those of Business A.

(B) Z contributes cash to P in exchange for a 20 percent interest in the capital and profits of P. The cash Z contributes to P is used in Business A and is reflected on Business A's books and records.

(ii) *Analysis*. (A) Under § 1.987–1(b)(5)(i), P is a section 987 aggregate partnership because X and Y own all the interests in partnership capital and profits, X and Y are related within the meaning of section 267(b), and the requirements of § 1.987–1(b)(5)(i)(B) are satisfied. Prior to the contribution to P by Z, X and Y each have a 50 percent allocable share of the assets and liabilities of Business A, as determined under § 1.987–7. Under § 1.987–1(b)(5)(ii), the assets and liabilities of Business A allocated to X are a section 987 QBU of X, and the assets and liabilities of Business A allocated to Y are a section 987 QBU of Y.

(B) Following Z's acquisition of a 20 percent interest in P, P remains a section 987 aggregate partnership because X, Y and Z own all the interests in partnership capital and profits; X, Y, and Z are related within the meaning of section 267(b); and the requirements of § 1.987–1(b)(5)(i)(B) are satisfied. Z acquires a 20 percent allocable share of the assets and liabilities of Business A, as determined under § 1.987–7. Under § 1.987–1(b)(5)(ii), the assets and liabilities of Business A allocated to Z are a section 987 QBU of Z (because Z becomes an indirect owner of Business A and Z and Business A have different functional currencies).

(C) As a result of Z's contribution of cash to Business A, through its contribution to P, each of X, Y, and Z are allocated a share of that Business A asset. Accordingly, under § 1.987–2(c)(5), Z is treated as contributing its allocable share of the cash to its Business A section 987 QBU. In addition, Z is treated as transferring X's and Y's respective allocable shares of the cash to X and Y, and X and Y are subsequently treated as transferring that cash to their respective Business A section 987 QBUs.

(D) In addition, as a result of Z's acquisition of its interest in P and Z's consequent acquisition of a Business A section 987 QBU, Z's allocable portion of the assets and liabilities of Business A (other than the cash) cease being reflected on the books and records of the respective Business A section 987 QBUs of each of X and Y. Those allocable portions of assets and liabilities from the Business A section 987 QBUs of X and Y are treated as if they are transferred from such section 987 QBUs to their respective owners, X and Y. These assets and liabilities are consequently recorded on the books and records of Z's Business A section 987 QBU. Accordingly, X and Y are treated as transferring those assets and liabilities to Z, and Z is treated as contributing those assets and liabilities to its new Business A section 987 QBU.

Example 7. *Acquisition of an interest in a partnership*. (i) *Facts*. The facts are the same as in *Example 6*, except that the cash that Z contributes to P in exchange for a 20 percent interest in P is not used in Business A and is not reflected on Business A's books and records. Instead, the cash is reflected on P's books and records.

(ii) *Analysis*. (A) Following Z's acquisition of a 20 percent interest in P, P remains a section 987 aggregate partnership because X, Y and Z own all the interests in partnership capital and profits; X, Y, and Z are related within the meaning of section 267(b); and the requirements of § 1.987–1(b)(5)(i)(B) are satisfied. Z acquires a 20 percent allocable share of the assets and liabilities of Business A, as determined under § 1.987–7. Under § 1.987–1(b)(5)(ii), the assets and liabilities of Business A allocated to Z are a section 987 QBU of Z (because Z becomes an indirect owner of Business A and Z and Business A have different functional currencies).

(B) As a result of Z's acquisition of its interest in P and Z's consequent acquisition of a Business A section 987 QBU, Z's allocable portion of the assets and liabilities of Business A cease being reflected on the books and records of

the respective Business A section 987 QBUs of each of X and Y. Those allocable portions of assets and liabilities from the Business A section 987 QBUs of X and Y are treated as if they are transferred from such section 987 QBUs to their respective owners, X and Y. These assets and liabilities are consequently recorded on the books and records of Z's Business A section 987 QBU. Accordingly, X and Y are treated as transferring those assets and liabilities to Z, and Z is treated as contributing those assets and liabilities to its new Business A section 987 QBU.

Example 8. *Conversion of a DE to a partnership through a sale of an interest*. (i) *Facts*. X owns all of the stock of Y and all of the interests in DE1. DE1 owns Business A. Y acquires 50 percent of the DE1 interests from X for cash.

(ii) *Analysis*. (A) DE1 is converted to a partnership when Y purchases the 50 percent interest in DE1. For Federal income tax purposes, Y's purchase of 50 percent of X's interest in DE1 is treated as the direct purchase of 50 percent of the assets of Business A because DE1 is disregarded and Business A is treated as held directly by X. Immediately after the sale of 50 percent of Business A to Y, X and Y are treated as contributing their respective interests in the assets of Business A to a partnership. See Rev. Rul. 99–5 (1999–1 CB 434) (situation 1) and § 601.601(d)(2) of this chapter.

(B) For purposes of this paragraph (c), these deemed transactions are disregarded transactions. Under § 1.987–1(b)(5)(i), the newly formed partnership is a section 987 aggregate partnership because X and Y own all the interests in partnership capital and profits, X and Y are related within the meaning of section 267(b), and the requirements of § 1.987–1(b)(5)(i)(B) are satisfied. Because Y is a partner in a section 987 aggregate partnership that owns Business A and because Y and Business A have different functional currencies, Y's portion of the Business A assets and liabilities constitutes a section 987 QBU of Y.

(C) As a result of the conversion of DE1 to a partnership, Y acquires an allocable share of 50 percent of the assets and liabilities of Business A, as determined under § 1.987–7. Accordingly, 50 percent of the assets and liabilities of Business A cease being reflected on the books and records of X's section 987 QBU. Under § 1.987–2(b)(5), these amounts are treated as if they are transferred from X's section 987 QBU to X, and X is treated as transferring these assets and liabilities to Y. Accordingly, the assets and liabilities of Business A allocated to Y are treated as transferred by Y to Y's newly formed Business A section 987 QBU.

Example 9. *Conversion of a DE to a partnership through a contribution*. (i) *Facts*. X owns all of the stock of Y and all of the interests in DE1. DE1 owns Business A. Y contributes property (that is not then attributed to a section 987 QBU of Y) to DE1 in exchange for an interest in DE1. The property transferred by Y to DE1 is used in Business A and is reflected on the books and records of Business A.

(ii) *Analysis*. (A) DE1 is converted to a partnership when Y contributes property to DE1 in exchange for a 50 percent interest in DE1. For Federal income tax purposes, Y's contribution is treated as a contribution to a partnership in

exchange for an ownership interest in the partnership. X is treated as contributing all of Business A to the partnership in exchange for a partnership interest. See Rev. Rul. 99–5 (situation 2), (1999–1 CB 434) and § 601.601(d)(2) of this chapter.

(B) For purposes of this paragraph (c), these deemed transactions are disregarded transactions. Under § 1.987–1(b)(5)(i), the newly formed partnership is a section 987 aggregate partnership because X and Y own all the interests in partnership capital and profits, X and Y are related within the meaning of section 267(b), and the requirements of § 1.987–1(b)(5)(i)(B) are satisfied. Because Y is a partner in a section 987 aggregate partnership that owns Business A and because Y and Business A have different functional currencies, Y's portion of the Business A assets and liabilities constitutes a section 987 QBU of Y.

(C) As a result of the conversion of DE1 to a partnership, Y acquires an allocable share of 50 percent of the assets and liabilities of Business A, as determined under § 1.987–7. Accordingly, under § 1.987–2(c)(5), Y is treated as contributing its allocable share of its contributed property to its Business A section 987 QBU. In addition, Y is treated as transferring X's allocable share of the contributed property to X, and X is subsequently treated as transferring that property to its Business A section 987 QBUs. In addition, Y's allocable share of the original (pre-conversion) assets and liabilities of Business A cease being reflected on the books and records of X's section 987 QBU. Under § 1.987–2(b)(5), these amounts are treated as if they are transferred from X's section 987 QBU to X, and X is treated as transferring these assets and liabilities to Y. Y is subsequently treated as transferring these assets and liabilities to Y's Business A section 987 QBU.

Example 10. *Contribution of assets to a corporation*. (i) *Facts*. X owns Business A. X forms Z, a domestic corporation, contributing 50 percent of its Business A assets and liabilities to Z in exchange for all of the stock of Z. X and Z do not file a consolidated tax return.

(ii) *Analysis*. Pursuant to paragraph (b)(2) of this section, the Z stock received in exchange for 50 percent of Business A's assets and liabilities is not reflected on the books and records of, and therefore is not attributable to, Business A for purposes of section 987 immediately after the exchange. As a result, pursuant to paragraph (c)(2)(i) and (ii) of this section, 50 percent of the assets and liabilities of Business A are treated as transferred from Business A to X in a disregarded transaction immediately before the exchange. The result would be the same even if X and Z filed a consolidated return.

Example 11. *Circular transfers*. (i) *Facts*. X owns Business A. On December 30, 2021, Business A purports to transfer €100 to X. On January 2, 2022, X purports to transfer €50 to Business A. On January 4, 2022, X purports to transfer another €50 to Business A. As of the end of 2021, X has an unrecognized section 987 loss with respect to Business A, such that a remittance, if respected, would result in recognition of a foreign currency loss under section 987.

(ii) *Analysis*. Because the transfer by Business A to X is offset by the transfers from X to Business A that occurred in close temporal proximity, the Internal Revenue Service (IRS) may disregard the purported transfers to and from Business A for purposes of section 987 pursuant to general tax principles under paragraph (c)(7) of this section.

Example 12. *Transfers without substance*. (i) *Facts*. X owns Business A and Business B. On January 1, 2021, Business A purports to transfer €100 to X. On January 4, 2021, X purports to transfer €100 to Business B. The account in which Business B deposited the €100 is used to pay the operating expenses and other costs of Business A. As of the end of 2021, X has an unrecognized section 987 loss with respect to Business A, such that a remittance, if respected, would result in recognition of a foreign currency loss under section 987.

(ii) *Analysis*. Because Business A continues to have use of the transferred property, the IRS may disregard the €100 purported transfer from Business A to X for purposes of section 987 pursuant to general tax principles under paragraph (c)(7) of this section.

Example 13. *Offsetting positions in section 987 QBUs*. (i) *Facts*. X owns Business A and Business B. Each of Business A and Business B has the euro as its functional currency. X has not made a grouping election under § 1.987–1(b)(2)(ii). On January 1, 2021, X borrows €1,000 from a third party lender, records the liability with respect to the borrowing on the books and records of Business A, and records the borrowed €1,000 on the books and records of Business B. On December 31, 2022, when Business A has $100 of net unrecognized section 987 loss and Business B has $100 of net unrecognized section 987 gain resulting from the change in exchange rates with respect to the liability and the €1,000, X terminates the Business A section 987 QBU.

(ii) *Analysis*. Because Business A and Business B have offsetting positions in the euro, the IRS will scrutinize the transaction under paragraph (b)(3) of this section to determine if a principal purpose of recording the euro-denominated liability on the books and records of Business A and the borrowed euros on the books and records of Business B was the avoidance of tax under section 987. If such a principal purpose is present, the IRS may reallocate the items (that is, the euros and the euro-denominated liability) between Business A, Business B, and X, under paragraph (c)(7) of this section to reflect the substance of the transaction.

Example 14. *Offsetting positions with respect to a section 987 QBU and a section 988 transaction*. (i) *Facts*. X owns all of the interests in DE1, and DE1 owns Business A. On January 1, 2021, X borrows €1,000 from a third party lender and records the liability with respect to the borrowing on its books and records. X contributes the €1,000 loan proceeds to DE1 and the €1,000 are reflected on the books and records of Business A. On December 31, 2022, when Business A has $100 of net unrecognized section 987 loss resulting from the change in

exchange rates with respect to the €1,000 received from the borrowing, and when the euro-denominated borrowing, if repaid, would result in $100 of gain under section 988, X terminates the Business A section 987 QBU.

(ii) *Analysis*. Because X and Business A have offsetting positions in the euro, the IRS will scrutinize the transaction under paragraph (b)(3) of this section to determine whether a principal purpose of recording the borrowed euros on the books and records of Business A, or not recording the corresponding euro-denominated liability on the books and records of Business A, was the avoidance of tax under section 987. If such a principal purpose is present, the Commissioner may reallocate the items (that is, the euros and the euro-denominated liability) between Business A and X under paragraph (c)(7) of this section to reflect the substance of the transaction.

Example 15. *Offsetting positions with respect to a section 987 QBU and a section 988 transaction*. (i) *Facts*. X owns all of the stock of Y and all of the interests in DE1. DE1 owns Business A. X and Y file a consolidated return. On January 1, 2021, DE1 lends €1,000 to Y. X records the receivable with respect to the loan on Business A's books and records. On December 31, 2022, when Business A has $100 of net unrecognized section 987 gain resulting from the loan, Y repays the €1,000 liability. The repayment of the euro-denominated borrowing results in $100 of loss to Y under section 988. X claims a $100 loss on its consolidated return under section 988. Business A does not make any remittances to X in 2022, so the offsetting gain with respect to the loan receivable has not been recognized by X.

(ii) *Analysis*. Y, a related party to X, and Business A have offsetting positions in the euro. The IRS will scrutinize the transaction under paragraph (b)(3) of this section to determine whether a principal purpose of recording the euro-denominated receivable on the books and records of Business A, rather than on the books and records of X, was to avoid tax through the use of section 987. If such a principal purpose is present, the IRS may reallocate the euro-denominated receivable between Business A and X under paragraph (c)(7) of this section to reflect the substance of the transaction. Other provisions may also apply to defer or disallow the loss.

Example 16. *Loan by section 987 QBU followed by immediate distribution to owner*. (i) *Facts*. X owns all of the interests in DE1. DE1 owns Business A. On January 1, 2021, Business A borrows €1,000 from a bank. On January 2, 2021, Business A distributes the €1,000 it received from the bank to X. There are no other transfers between X and Business A during the year. At the end of the year, X has net unrecognized section 987 loss with respect to Business A such that a remittance would result in the recognition of foreign currency loss under section 987.

(ii) *Analysis*. Because the proceeds from the loan to Business A are immediately transferred to X and the distribution from Business A to X could result in the recognition of section 987 loss, the IRS may scrutinize the recording of the loan

on the books of Business A and move the loan onto the books of X, resulting in the transfer not being taken into account for purposes of section 987 under paragraph (b)(3) of this section.

Example 17. *Payment of interest by section 987 QBU on obligation of owner*. (i) *Facts*. X owns all of the interests in DE1. DE1 owns business A. On January 1, X borrows €1,000 from a bank. On July 1, Business A pays €20 in interest on X's €1,000 obligation to the bank.

(ii) *Analysis*. Under general tax law principles as provided in paragraph (c)(7) of this section, on July 1, 2021, Business A is treated for purposes of section 987 as making a transfer of €20 to X, and X is treated as making a €20 interest payment to the bank.

(d) *Translation of items transferred to a section 987 QBU*—(1) *Marked items*. The adjusted basis of a marked asset, or the amount of a marked liability, transferred to a section 987 QBU shall be translated into the section 987 QBU's functional currency at the spot rate (as defined in § 1.987–1(c)(1)) applicable to the date of transfer. If the asset or liability transferred is denominated in (or determined by reference to) the functional currency of the section 987 QBU (for example, cash or a note denominated in the functional currency of the section 987 QBU), no translation is required. See § 1.988–1(a)(10)(ii) for special rules regarding intra-taxpayer transfers.

(2) *Historic items*. The adjusted basis of a historic asset, or the amount of a historic liability, transferred to a section 987 QBU shall be translated into the section 987 QBU's functional currency at the rate provided in § 1.987–1(c)(3).

§ 1.987–3 Determination of section 987 taxable income or loss of an owner of a section 987 QBU.

(a) *In general*. This section provides rules for determining the taxable income or loss, or the earnings and profits, of an owner of a section 987 QBU (hereafter, section 987 taxable income or loss). Paragraph (b) of this section provides rules for determining items of income, gain, deduction, and loss, which generally must be determined in the section 987 QBU's functional currency. Paragraph (c) of this section provides rules for translating each item determined under paragraph (b) of this section into the functional currency of the owner of the section 987 QBU, if necessary. Paragraph (e) of this section provides examples illustrating the application of the rules of this section.

(b) *Determination of each item of income, gain, deduction, or loss in the section 987 QBU's functional currency*—(1) *In general*. Except as otherwise provided in this section, a section 987 QBU shall determine each item of income, gain, deduction, or loss of such section 987 QBU in its functional currency under Federal income tax principles.

(2) *Translation of items of income, gain, deduction, or loss that are denominated in a nonfunctional currency*—(i) *In general*. Except as otherwise provided in paragraphs (b)(2)(ii) and (b)(4) of this section, an item of income, gain,

deduction, or loss that is denominated in (or determined by reference to) a nonfunctional currency (including the functional currency of the owner) shall be translated into the section 987 QBU's functional currency at the spot rate (as defined in § 1.987–1(c)(1)) on the date such item is properly taken into account, subject to the limitation under § 1.987–1(c)(1)(ii)(B) regarding the use of a spot rate convention. Examples 1, 2 and 6 of paragraph (e) of this section illustrate the application of this paragraph (b)(2)(i).

(ii) [Reserved].

(3) *Determination in the case of a section 987 QBU owned through a section 987 aggregate partnership*—(i) *In general*. Except as otherwise provided in this paragraph (b)(3), the taxable income or loss of a section 987 aggregate partnership, and the distributive share of any owner that is a partner in such partnership, shall be determined in accordance with the provisions of subchapter K of the Internal Revenue Code.

(ii) *Determination of each item of income, gain, deduction, or loss in the eligible QBU's functional currency*. A section 987 aggregate partnership generally shall determine each item of income, gain, deduction, or loss reflected on the books and records of each of its eligible QBUs under § 1.987–2(b) in the functional currency of each such QBU.

(iii) *Allocation of items of income, gain, deduction, or loss of an eligible QBU.* A section 987 aggregate partnership shall allocate the items of income, gain, deduction, or loss of each eligible QBU among its partners in accordance with each partner's distributive share of such income, gain, deduction, or loss as determined under subchapter K of the Internal Revenue Code.

(iv) *Translation of items into the owner's functional currency*. To the extent the items referred to in paragraph (b)(3)(iii) of this section are allocated to a partner, the partner shall adjust the items to conform to Federal income tax principles and translate the items into the partner's functional currency as provided in paragraph (c) of this section.

(4) [Reserved].

(c) *Translation of items of income, gain, deduction, or loss of a section 987 QBU into the owner's functional currency*—(1) *In general*. Except as otherwise provided in this section, the exchange rate to be used by an owner in translating an item of income, gain, deduction, or loss attributable to a section 987 QBU into the owner's functional currency, if necessary, shall be the yearly average exchange rate (as defined in § 1.987–1(c)(2)) for the taxable year. However, an owner of a section 987 QBU that has elected under § 1.987–1(c)(1)(iii) to use spot rates in lieu of yearly average exchange rates must use the spot rate (as defined in § 1.987–1(c)(1)) for the date each item is properly taken into account.

(2) *Exceptions*—(i) *Recovery of basis with respect to historic assets*. Except as otherwise provided in this section, the exchange rate to be used by the owner in translating any recovery of basis (whether through a sale or exchange; deemed sale or exchange; cost recovery deduction such as depreciation, depletion or

amortization; or otherwise) with respect to a historic asset (as defined in § 1.987–1(e)) shall be the historic rate as determined under § 1.987–1(c)(3) for the property to which such recovery of basis is attributable.

(ii) [Reserved].

(iii) *Gain or loss on the sale, exchange or other disposition of an interest in a section 987 aggregate partnership*. [Reserved].

(iv) *Cost of goods sold computation*.—(A) *General rule—simplified inventory method*. Cost of goods sold (COGS) for a taxable year shall be translated into the functional currency of the owner at the yearly average exchange rate (as defined in § 1.987–1(c)(2)) for the taxable year and adjusted as provided in paragraph (c)(3) of this section.

(B) *Election to use the historic inventory method*. In lieu of using the simplified inventory method described in paragraph (c)(2)(iv)(A) of this section, the owner of a section 987 QBU may elect under this paragraph (c)(2)(iv)(B) to translate inventoriable costs (including current-year inventoriable costs and costs that were capitalized into inventory in prior years) that are included in COGS at the historic rate as determined under § 1.987–1(c)(3) for each such cost. As described in § 1.987–1(c)(1)(iii), a taxpayer that elects to use spot rates in lieu of yearly average exchange rates as provided in that section will be deemed to have made the election described in this paragraph (c)(2)(iv)(B).

(3) *Adjustments to COGS required under the simplified inventory method*—(i) *In general*. An owner of a section 987 QBU that uses the simplified inventory method described in paragraph (c)(2)(iv)(A) of this section must make the adjustment described in paragraph (c)(3)(ii) of this section. In addition, the owner must make the adjustment described in paragraph (c)(3)(iii) of this section with respect to any inventory for which the section 987 QBU does not use the LIFO inventory method (as described in section 472) and must make the adjustment described in paragraph (c)(3)(iv) of this section with respect to any inventory for which the section 987 QBU uses the LIFO inventory method. An owner of a section 987 QBU that uses the simplified inventory method must make all of the applicable adjustments described in paragraphs (c)(3)(ii) through (iv) with respect to the section 987 QBU even in taxable years in which the amount of COGS is zero.

(ii) *Adjustment for cost recovery deductions included in inventoriable costs*. The translated COGS amount computed under paragraph (c)(2)(iv)(A) of this section must be increased or decreased (as appropriate) to reflect the difference between the historic rates appropriate for translating cost recovery deductions attributable to other historic assets and the exchange rate used to translate COGS under paragraph (c)(2)(iv)(A) of this section, to the extent any such cost recovery deductions are included in inventoriable costs for the taxable year. The adjustment shall be included as an adjustment to translated COGS computed under paragraph (c)(2)(iv)(A) of this section in full in the year to which the

adjustment relates and shall not be allocated between COGS and ending inventory. The adjustment for each cost recovery deduction shall be computed as the product of:

(A) The cost recovery deduction, expressed in the functional currency of the section 987 QBU; and

(B) The exchange rate specified in paragraph (c)(2)(i) of this section for translating the cost recovery deduction (that is, the historic rate for the property to which such deduction is attributable) less the exchange rate used to translate COGS under the simplified inventory method described in paragraph (c)(2)(iv)(A) of this section (that is, the yearly average exchange rate for the taxable year).

(iii) *Adjustment to beginning inventory for non-LIFO inventory*. In the case of inventory with respect to which a section 987 QBU does not use the LIFO inventory method (non-LIFO inventory), the translated COGS amount computed under paragraph (c)(2)(iv)(A) of this section must be increased or decreased (as appropriate) by the product of:

(A) The ending non-LIFO inventory included on the closing balance sheet for the preceding year, expressed in the functional currency of the section 987 QBU; and

(B) The exchange rate described in §§ 1.987–4(e)(2)(ii) and 1.987–1(c)(3)(i)(C) that is used for translating ending inventory on the closing balance sheet for the preceding year (that is, the yearly average exchange rate for the preceding year) less the exchange rate used to translate COGS under paragraph (c)(2)(iv)(A) of this section (that is, the yearly average exchange rate for the taxable year).

(iv) *Adjustment for year of LIFO liquidation*. In the case of inventory with respect to which a section 987 QBU uses the LIFO inventory method, for each LIFO layer liquidated in whole or in part during the taxable year, the translated COGS amount computed under paragraph (c)(2)(iv)(A) of this section must be increased or decreased (as appropriate) by the product of:

(A) The amount of the LIFO layer liquidated during the taxable year, expressed in the functional currency of the section 987 QBU; and

(B) The exchange rate described in §§ 1.987–4(e)(2)(ii) and 1.987–1(c)(3)(i)(C) that is used for translating such LIFO layer (that is, the yearly average exchange rate for the year such LIFO layer arose) less the exchange rate used to translate COGS under paragraph (c)(2)(iv)(A) of this section (that is, the yearly average exchange rate for the taxable year).

(d) [Reserved].

(e) *Examples*. The following examples illustrate the application of this section. For purposes of the examples, U.S. Corp is a domestic corporation that uses the calendar year as its taxable year and has the U.S. dollar as its functional currency. Except as otherwise indicated, U.S. Corp is the owner of Business A, a section 987 QBU with the euro as its functional currency, and elects under paragraph (c)(2)(iv)(B) of this section to use the historic inventory method with

respect to Business A but does not make any other elections under section 987. However, where it is specified that U.S. Corp elects to use spot rates in lieu of yearly average exchange rates under § 1.987–1(c)(1)(iii), U.S. Corp also elects under § 1.987–1(c)(1)(ii) to use a spot rate convention. Under this convention, sales booked during a particular month are translated at the average of the spot rates on the first and last day of the preceding month (the "convention rate"). Exchange rates used in these examples are selected for the purpose of illustrating the principles of this section. No inference (for example, whether a currency is hyperinflationary or not) is intended by their use. See § 1.987–4(g) for an illustration of the simplified inventory method described in paragraphs (c)(2)(iv)(A) and (c)(3) of this section.

Example 1. Business A properly accrues £100 of income from the provision of services. Under paragraph (b)(2)(i) of this section, the £100 is translated into €90 at the spot rate (as defined in § 1.987–1(c)(1)) on the date of accrual, without the use of a spot rate convention. In determining U.S. Corp's taxable income, the €90 of income is translated into dollars at the rate provided in paragraph (c)(1) of this section.

Example 2. Business A sells a historic asset consisting of non-inventory property for £100. Under paragraph (b)(2)(i) of this section, the £100 amount realized is translated into €85 at the spot rate (as defined in § 1.987–1(c)(1)) on the sale date without the use of a spot rate convention. In determining U.S. Corp's taxable income, the €85 is translated into dollars at the rate provided in paragraph (c)(1) of this section. The euro basis of the property is translated into dollars at the rate provided in paragraph (c)(2)(i) of this section (that is, the historic rate as determined under § 1.987–1(c)(3)).

Example 3. (i) Business A uses a first-in, first-out (FIFO) method of accounting for inventory. Business A sells 1,200 units of inventory in 2021 for €3 per unit. Business A's gross sales are translated under paragraph (c)(1) of this section at the yearly average exchange rate for the year of the sale. The yearly average exchange rate is €1 = $1.02 for 2020 and €1 = $1.05 for 2021. Thus, Business A's dollar gross sales will be computed as follows:

Gross Sales (2021)				
Month	***# of units***	***Amount in €***	***€/$ yearly average rate***	***Amount in $***
Jan	100	€300	€1 = $1.05	$315.00
Feb	200	600	€1 = $1.05	630.00
March	0	0	€1 = $1.05	0
April	200	600	€1 = $1.05	630.00
May	100	300	€1 = $1.05	315.00

Gross Sales (2021)				
Month	***# of units***	***Amount in €***	***€/$ yearly average rate***	***Amount in $***
June	0	0	€1 = $1.05	0
July	100	300	€1 = $1.05	315.00
Aug	100	300	€1 = $1.05	315.00
Sept	0	0	€1 = $1.05	0
Oct	0	0	€1 = $1.05	0
Nov	100	300	€1 = $1.05	315.00
Dec	300	900	€1 = $1.05	*945.00*
	1,200			$3,780.00

(ii) The purchase price for each inventory unit was €1.50. Under § 1.987–1(c)(3)(i) and paragraph (c)(2)(iv)(B) of this section, the basis of each item of inventory is translated into dollars at the yearly average exchange rate for the year the inventory was acquired.

Opening Inventory and Purchases (2021)				
Month	***# of units***	***Amount in €***	***€/$ yearly average rate***	***Amount in $***
Opening inventory (purchased in Dec. 2020)				
	100	€150	€1 = $1.02	$153.00
Purchases in 2021				
Jan	300	€450	€1 = $1.05	$472.50
Feb	0	0	€1 = $1.05	0
March	0	0	€1 = $1.05	0
April	300	450	€1 = $1.05	472.50
May	0	0	€1 = $1.05	0
June	0	0	€1 = $1.05	0
July	300	450	€1 = $1.05	472.50

Opening Inventory and Purchases (2021)				
Month	***# of units***	***Amount in €***	***€/$ yearly average rate***	***Amount in $***
Aug	0	0	€1 = $1.05	0
Sept	0	0	€1 = $1.05	0
Oct	0	0	€1 = $1.05	0
Nov	300	450	€1 = $1.05	472.50
Dec	0	0	€1 = $1.05	0
	1,200			$1,890.00

(iii) Because Business A uses a FIFO method for inventory, Business A is considered to have sold in 2021 the 100 units of opening inventory purchased in 2020 ($153.00), the 300 units purchased in January 2021 ($472.50), the 300 units purchased in April 2021 ($472.50), the 300 units purchased in July 2021 ($472.50), and 200 of the 300 units purchased in November 2021 ($315.00). Accordingly, Business A's translated dollar COGS for 2021 is $1,885.50. Business A's opening inventory for 2022 is 100 units of inventory with a translated dollar basis of $157.50.

(iv) Accordingly, for purposes of section 987 Business A has gross income in dollars of $1,894.50 ($3,780.00 – $1,885.50).

Example 4. (i) The facts are the same as in *Example 3* except that U.S. Corp properly elects under paragraph § 1.987–1(c)(1)(iii) to use spot rates in lieu of yearly average exchange rates. As a result, under paragraph (c)(3) of this section, U.S. Corp uses the convention rate to translate items of income, gain, deduction, or loss where such rate is appropriate. Thus, Business A's dollar gross sales will be computed as follows:

Gross Sales (2021)				
Sales	***# of units***	***Amount in €***	***€/$ yearly average rate***	***Amount in $***
Jan	100	€300	€1 = $1.00	$300
Feb	200	600	€1 = $1.05	630
March	0	0	€1 = $1.03	0
April	200	600	€1 = $1.02	612

Gross Sales (2021)				
Sales	***# of units***	***Amount in €***	***€/$ yearly average rate***	***Amount in $***
May	100	300	€1 = $1.04	312
June	0	0	€1 = $1.05	0
July	100	300	€1 = $1.06	318
Aug	100	300	€1 = $1.05	315
Sept	0	0	€1 = $1.06	0
Oct	0	0	€1 = $1.07	0
Nov	100	300	€1 = $1.08	324
Dec	300	900	€1 = $1.08	972
	1,200			$3,783

(ii) As in *Example 3*, the purchase price for each inventory unit was €1.50. Under § 1.987–3(c)(2)(iv)(B), U.S. Corp uses the convention rate as the historic rate in determining COGS.

Opening Inventory and Purchases (2021)				
Month	***# of units***	***Amount in €***	***€/$ yearly average rate***	***Amount in $***
Opening inventory (purchased in Dec. 2020)				
	100	€150	€1 = $1.00	$150
Purchases in 2021				
Jan	300	€450	€1 = $1.00	$450
Feb	0	0	€1 = $1.05	0
March	0	0	€1 = $1.03	0
April	300	450	€1 = $1.02	459
May	0	0	€1 = $1.04	0
June	0	0	€1 = $1.05	0
July	300	450	€1 = $1.06	477

Opening Inventory and Purchases (2021)				
Month	***# of units***	***Amount in €***	***€/$ yearly average rate***	***Amount in $***
Aug	0	0	€1 = $1.05	0
Sept	0	0	€1 = $1.06	0
Oct	0	0	€1 = $1.07	0
Nov	300	450	€1 = $1.08	486
Dec	0	0	€1 = $1.08	0
	1,200			$1,872

(iii) As set forth in (i), Business A's gross sales are $3783.

(iv) Because Business A uses a FIFO method for inventory, Business A is considered to have sold in 2021 the 100 units of opening inventory purchased in December 2020 ($150), the 300 units purchased in January 2021 ($450), the 300 units purchased in April 2021 ($459), the 300 units purchased in July 2021 ($477), and 200 of the 300 units purchased in November 2021 ($324). Thus, Business A's COGS is $1,860.

(v) Accordingly, Business A has gross income in dollars of $1,923 ($3,783 – $1,860).

Example 5. The facts are the same as in *Example 3* except that during 2021, Business A incurred €100 of depreciation expense with respect to a truck. No portion of the depreciation expense is an inventoriable cost. The truck was purchased on January 15, 2020. The yearly average exchange rate for 2020 was €1 = $1.02. Under paragraph (c)(2)(i) of this section, the €100 of depreciation is translated into dollars at the historic rate. Under § 1.987–1(c)(3)(i), the historic rate is the yearly average rate for 2020. Accordingly, U.S. Corp takes into account depreciation of $102 with respect to Business A in 2021.

Example 6. The facts are the same as in *Example 5* except that the €100 of depreciation expense incurred during 2021 with respect to the truck is an inventoriable cost. As a result, the depreciation expense is capitalized into the 1,200 units of inventory purchased by Business A in 2021. Of those 1,200 units, 1,100 units are sold during the year, and 100 units become ending inventory. The portion of depreciation expense capitalized into inventory that is sold during 2021 is reflected in Business A's euro COGS and is translated at the €1 = $1.02 yearly average exchange rate for 2020, the year in which the truck was purchased. The portion of the depreciation expense capitalized into the 100 units of ending inventory is not taken into account in 2021 but, rather, will be taken into account in the year the ending inventory is sold, translated at the €1 = $1.02 yearly average exchange rate for 2020.

Example 7. Business A purchased raw land on October 16, 2020, for €8,000 and sold the land on November 1, 2021, for €10,000. The yearly average exchange rate was €1 = $1.02 for 2020 and €1 = $1.05 for 2021. Under paragraph (c)(1) of this section, the amount realized is translated into dollars at the yearly average exchange rate for 2021 (€10,000 x $1.05 = $10,500). Under paragraph (c)(2)(i) of this section, the basis is determined at the historic rate for 2020, which is the yearly average rate under section § 1.987–1(c)(3)(i) for such year (€8,000 x $1.02 = $8,160). Accordingly, the amount of gain reported by U.S. Corp on the sale of the land is $2,340 ($10,500 – $8,160).

Example 8. The facts are the same as in *Example 7* except that Business A properly elects under paragraph § 1.987–1(c)(1)(iii) to use spot rates in lieu of yearly average rates. Accordingly, the amount realized will be translated at the convention rate for the date of sale, and the basis will be translated at the convention rate for the date of purchase. The convention rate is €1 = $1.01 for October 2020 and is €1 = $1.08 for November 2021. Under these facts, the amount realized, translated into dollars at the convention rate for November 2021, is $10,800 (€10,000 x $1.08), and the basis, translated at the convention rate for October 2020, is $8,080 (€8,000 x $1.01). The amount of gain reported by U.S. Corp on the sale of the land is $2,720 ($10,800 – $8,080).

§ 1.987–4 Determination of net unrecognized section 987 gain or loss of a section 987 QBU.

(a) *In general*. The net unrecognized section 987 gain or loss of a section 987 QBU shall be determined by the owner annually as provided in paragraph (b) of this section in the owner's functional currency. Only assets and liabilities reflected on the books and records of the section 987 QBU under § 1.987–2(b) shall be taken into account.

(b) *Calculation of net unrecognized section 987 gain or loss*. Net unrecognized section 987 gain or loss of a section 987 QBU for a taxable year shall equal the sum of:

(1) The section 987 QBU's net accumulated unrecognized section 987 gain or loss for all prior taxable years to which these regulations apply as determined in paragraph (c) of this section, and

(2) The section 987 QBU's unrecognized section 987 gain or loss for the current taxable year as determined in paragraph (d) of this section.

(c) *Net accumulated unrecognized section 987 gain or loss for all prior taxable years*—(1) *In general*. A section 987 QBU's net accumulated unrecognized section 987 gain or loss for all prior taxable years is the aggregate of the amounts determined under § 1.987–4(d) for all prior taxable years to which these regulations apply, reduced by the amounts taken into account under § 1.987–5 upon remittances for all such prior taxable years.

(2) [Reserved].

(d) *Calculation of unrecognized section 987 gain or loss for a taxable year.* The unrecognized section 987 gain or loss of a section 987 QBU for a taxable year shall be determined under paragraphs (d)(1) through (8) of this section.

(1) *Step 1: Determine the change in the owner functional currency net value of the section 987 QBU for the taxable year*—(i) *In general*. The change in the owner functional currency net value of the section 987 QBU for the taxable year shall equal—

(A) The owner functional currency net value of the section 987 QBU, determined in the functional currency of the owner under paragraph (e) of this section, on the last day of the taxable year; less

(B) The owner functional currency net value of the section 987 QBU, determined in the functional currency of the owner under paragraph (e) of this section, on the last day of the preceding taxable year. This amount shall be zero in the case of the section 987 QBU's first taxable year.

(ii) *Year section 987 QBU is terminated*. If a section 987 QBU is terminated within the meaning of § 1.987–8 during an owner's taxable year, the owner functional currency net value of the section 987 QBU as provided in paragraph (d)(1)(i)(A) of this section shall be determined on the date the section 987 QBU is terminated.

(2) *Step 2: Increase the amount determined in step 1 by the amount of assets transferred from the section 987 QBU to the owner*—(i) *In general.* The amount determined in paragraph (d)(1) of this section shall be increased by the total amount of assets described in paragraph (d)(2)(ii) of this section transferred from the section 987 QBU to the owner during the taxable year translated into the owner's functional currency as provided in paragraph (d)(2)(ii) of this section.

(ii) *Assets transferred from the section 987 QBU to the owner during the taxable year*. The assets transferred from the section 987 QBU to the owner for the taxable year shall equal the sum of:

(A) The amount of the section 987 QBU's functional currency and the aggregate adjusted basis of all marked assets (as defined in § 1.987–1(d)), after taking into account § 1.988–1(a)(10), transferred to the owner during the taxable year determined in the functional currency of the section 987 QBU and translated into the owner's functional currency at the spot rate (as defined in § 1.987–1(c)(1)) applicable to the date of transfer; and

(B) The aggregate adjusted basis of all historic assets (as defined in § 1.987–1(e)), after taking into account § 1.988–1(a)(10), transferred to the owner during the taxable year determined in the functional currency of the section 987 QBU and translated into the owner's functional currency at the historic rate for each such asset (as defined in § 1.987–1(c)(3)).

(3) *Step 3: Decrease the amount determined in steps 1 and 2 by the amount of assets transferred from the owner to the section 987 QBU*—(i) *In general*. The aggregate amount determined in paragraphs (d)(1) and (d)(2) of this section shall be decreased by the total amount of assets transferred from the owner to the section 987 QBU during the taxable year determined in the functional currency of the owner as provided in paragraph (d)(3)(ii) of this section.

(ii) *Total of all amounts transferred from the owner to the section 987 QBU during the taxable year*. The total amount of assets transferred from the owner to the section 987 QBU for the taxable year shall equal the aggregate of:

(A) The total amount of functional currency of the owner transferred to the section 987 QBU during the taxable year; and

(B) The adjusted basis, determined in the functional currency of the owner, of any asset transferred to the section 987 QBU during the taxable year (after taking into account § 1.988–1(a)(10)).

(4) *Step 4: Decrease the amount determined in steps 1 through 3 by the amount of liabilities transferred from the section 987 QBU to the owner*. The aggregate amount determined in paragraphs (d)(1) through (3) of this section shall be decreased by the aggregate amount of liabilities transferred from the section 987 QBU to the owner during the taxable year. The amount of such liabilities shall be translated into the functional currency of the owner at the spot rate (as defined in § 1.987–1(c)(1)) applicable on the date of transfer.

(5) *Step 5: Increase the amount determined in steps 1 through 4 by the amount of liabilities transferred from the owner to the section 987 QBU*. The aggregate amount determined in paragraphs (d)(1) through (4) of this section shall be increased by the aggregate amount of liabilities transferred by the owner to the section 987 QBU during the taxable year. The amount of such liabilities shall be translated into the functional currency of the owner at the spot rate (as defined in § 1.987–1(c)(1)) applicable on the date of transfer.

(6) *Step 6: Decrease or increase the amount determined in steps 1 through 5 by the section 987 taxable income or loss, respectively, of the section 987 QBU for the taxable year*. The aggregate amount determined in paragraphs (d)(1) through (5) of this section shall be decreased or increased by the section 987 taxable income or loss, respectively, computed under § 1.987–3 for the taxable year.

(7) *Step 7: Increase the amount determined in steps 1 through 6 by any expenses that are not deductible in computing the section 987 taxable income or loss of the section 987 QBU for the taxable year*. The aggregate amount determined under paragraphs (d)(1) through (6) shall be increased by the amount of any expense or loss attributable to a section 987 QBU for the taxable year that is not deductible in computing the section 987 QBU's taxable income or loss for the year, including any foreign income taxes incurred by the section 987 QBU with respect to which the owner claims a credit (translated at the same rate at which such taxes were translated under section 986(a)).

(8) *Step 8: Decrease the amount determined in steps 1 through 7 by the amount of any tax-exempt income*. The aggregate amount determined under paragraphs (d)(1) through (7) shall be decreased by the amount of any income or gain attributable to a section 987 QBU for the taxable year that is not included in computing the section 987 QBU's taxable income or loss for the year.

(e) *Determination of the owner functional currency net value of a section 987 QBU* —(1) *In general*. The owner functional currency net value of a section 987 QBU on the last day of a taxable year shall equal the aggregate amount of functional currency and the adjusted basis of each asset on the section 987 QBU's balance sheet on that day, less the aggregate amount of each liability on the section 987 QBU's balance sheet on that day, in each case translated into the owner's functional currency as provided in paragraph (e)(2) of this section. Such amount shall be determined by:

(i) Preparing a balance sheet for the relevant date from the section 987 QBU's books and records (within the meaning of § 1.989(a)–1(d)), as recorded in the section 987 QBU's functional currency and showing all assets and liabilities reflected on such books and records as provided in § 1.987–2(b);

(ii) Making adjustments necessary to conform the items reflected on the balance sheet described in paragraph (e)(1)(i) of this section to United States tax accounting principles; and

(iii) Translating the asset and liability amounts on the adjusted balance sheet described in paragraph (e)(1)(ii) of this section into the functional currency of the owner in accordance with paragraph (e)(2) of this section.

(2) *Translation of balance sheet items into the owner's functional currency*. The amount of the section 987 QBU's functional currency, the basis of an asset, or the amount of a liability shall be translated as follows:

(i) *Marked item*. A marked item (as defined in § 1.987–1(d)) shall be translated into the owner's functional currency at the spot rate (as defined in § 1.987–1(c)(1)) applicable to the last day of the relevant taxable year.

(ii) *Historic item*. A historic item (as defined in § 1.987–1(e)) shall be translated into the owner's functional currency at the historic rate (as defined in § 1.987–1(c)(3)).

(f) [Reserved].

(g) *Examples.* The following examples illustrate the provisions of this section. For purposes of the examples, U.S. Corp is a domestic corporation that uses the calendar year as its taxable year and has the dollar as its functional currency. Except as otherwise indicated, U.S. Corp elects under § 1.987–3(c)(2)(iv)(B) to use the historic inventory method with respect to all of its section 987 QBUs but does not make other elections under section 987. Exchange rate and tax accounting (for example, depreciation rate) assumptions used in these examples are selected for the purpose of illustrating the principles of this section, and no inference is intended by their use. Additionally, the examples

are not intended to demonstrate when activities constitute a trade or business within the meaning of § 1.989(a)–1(b)(2)(ii)(A) and § 1.989(a)–1(c) and therefore whether a section 987 QBU is considered to exist.

Example 1. (i) On July 1, 2021, U.S. Corp establishes Japan Branch, a section 987 QBU of U.S. Corp that has the yen as its functional currency, and transfers to Japan Branch $1,000 and raw land with a basis of $500. Japan Branch immediately exchanges the $1,000 for ¥100,000. On the same day, Japan Branch borrows ¥10,000. For the taxable year 2021, Japan Branch earns ¥2,000 per month (total of ¥12,000 for the six-month period from July 1, 2021, through December 31, 2021) for providing services and incurs ¥333.33 per month (total of ¥2,000 when rounded for the six-month period from July 1, 2021, through December 31, 2021) of related expenses. Assume that the spot rate on July 1, 2021, is $1 = ¥100; the spot rate on December 31, 2021, is $1 = ¥120; and the average rate for the period of July 1, 2021, to December 31, 2021, is $1 = ¥110. Thus, the ¥12,000 of services revenue when properly translated under § 1.987–3(c)(1) at the yearly average exchange rate equals $109.09 (¥12,000 x ($1 / ¥110)) = $109.09). The ¥2,000 of expenses translated at the same yearly average exchange rate equals $18.18 (¥2,000 x ($1 / ¥110) = $18.18). Thus, Japan Branch's net income translated into dollars equals $90.91 ($109.09 – $18.18 = $90.91).

(ii) Under paragraph (a) of this section, U.S. Corp must compute the net unrecognized section 987 gain or loss of Japan Branch for 2021. Because this is Japan Branch's first taxable year, the net unrecognized section 987 gain or loss (as defined under paragraph (b) of this section) is the branch's unrecognized section 987 gain or loss for 2021 as determined in paragraph (d) of this section. The calculation under paragraph (d) of this section is made as follows:

(iii) *Step 1*. Under paragraph (d)(1) of this section, U.S. Corp must determine the change in the owner functional currency net value (OFCNV) of Japan Branch for 2021 in dollars. The change in the OFCNV of Japan Branch for 2021 is equal to the OFCNV of Japan Branch determined in dollars on the last day of 2021, less the OFCNV of Japan Branch determined in dollars on the last day of the preceding taxable year.

(A) The OFCNV of Japan Branch determined in dollars on the last day of the current taxable year is determined under paragraph (e) of this section as the sum of the basis of each asset on Japan Branch's balance sheet on December 31, 2021, less the sum of each liability on Japan Branch's balance sheet on that date, translated into dollars as provided in paragraph (e)(2) of this section.

(B) For this purpose, Japan Branch will show the following assets and liabilities on its balance sheet for December 31, 2021:

(1) ¥120,000;

(2) Raw land with a basis of ¥55,000 ($500 translated under § 1.987–2(d)(2) at the historic rate of $1 = ¥110); and

(3) Liabilities of ¥10,000.

(C) Under paragraph (e)(2) of this section, U.S. Corp will translate these items as follows. The ¥120,000 is a marked asset and the ¥10,000 liability is a marked liability (as each is defined in § 1.987–1(d)). These items are translated into dollars on December 31, 2021, using the spot rate on December 31, 2021, of $1 = ¥120. The raw land is a historic asset (as defined in § 1.987–1(e)) and is translated into dollars under paragraph (e)(2)(ii) of this section at the historic rate, which under § 1.987–1(c)(3)(1)(A) is the yearly average exchange rate of $1 = ¥110 applicable to the year the land was transferred to the QBU. Thus, the OFCNV of Japan Branch on December 31, 2021, in dollars is $1,416.67 determined as follows:

Assets	*Amount in ¥*	*Translation Rate*	*Amount in $*
Yen	¥120,000	$1 = ¥120 (spot rate-12/31/21)	$1,000.00
Land	55,000	$1 = ¥110 (yearly average rate-2021)	500.00
Total assets			$1,500.00
Liabilities			
Bank Loan	¥10,000	$1 = ¥120 (spot rate-12/31/21)	$83.33
Total liabilities			$83.33
2021 ending OFCNV			$1,416.67

(D) Under paragraph (d)(1) of this section, the change in OFCNV of Japan Branch for 2021 is equal to the OFCNV of the branch determined in dollars on December 31, 2021, ($1,416.67) less the OFCNV of the branch determined in dollars on the last day of the preceding taxable year. Because this is the first taxable year of Japan Branch, the OFCNV of Japan Branch determined in dollars on the last day of the preceding taxable year is zero under paragraph (d)(1)(i)(B) of this section. Accordingly, the change in OFCNV of Japan Branch for 2021 is $1,416.67.

(iv) *Step 2*. Under paragraph (d)(2) of this section, the aggregate amount determined in paragraph (d)(1) of this section (step 1) is increased by the total amount of assets described in paragraph (d)(2)(ii) of this section transferred from the section 987 QBU to the owner during the taxable year translated into the owner's functional currency as provided in paragraph (d)(2)(ii) of this section. Because no such amounts were transferred, there is no change in the $1,416.67 determined in step 1.

(v) *Step 3*. Under paragraph (d)(3) of this section, the aggregate amount determined in paragraphs (d)(1) and (d)(2) of this section (steps 1 and 2) is decreased by the total amount of assets transferred from the owner to the section 987 QBU during the taxable year as determined in paragraph (d)(3)(ii) of this section in dollars. On July 1, 2021, U.S. Corp transferred to Japan Branch $1,000.00 (which Japan Branch immediately converted into ¥100,000) and raw land with a basis of $500.00 (equal to ¥55,000, translated under § 1.987–2(d)(2) at the historic rate of $1 = ¥110). Thus, the $1,416.67 determined under steps 1 and 2 is reduced by $1,500.00, resulting in ($83.33).

(vi) *Steps 4 and 5*. Because no liabilities were transferred by U.S. Corp to Japan Branch or by Japan Branch to U.S. Corp during the taxable year, the aggregate amount determined in paragraph (d)(3) of this section (Step 3) is not increased or decreased.

(vii) *Step 6*. Under paragraph (d)(6) of this section, the aggregate amount determined after applying paragraphs (d)(1) through (5) of this section (steps 1 through 5) is decreased by the section 987 taxable income of Japan Branch of $90.91 from ($83.33) to ($174.24).

(viii) *Steps 7 and 8*. Paragraphs (d)(7) and (d)(8) do not apply because Japan Branch does not have any tax-exempt or nondeductible items. Accordingly, the unrecognized section 987 loss of Japan Branch for 2021 is ($174.24), the amount determined after applying step 6.

Example 2. (i) U.S. Corp operates in the United Kingdom through U.K. Branch, a section 987 QBU of U.S. Corp that has the pound as its functional currency. U.S. Corp properly elects under § 1.987–1(c)(1)(ii) for U.K. Branch to use a spot rate convention (when permitted). Under the chosen convention, the spot rate (the "convention rate") for any transaction occurring during a month is the average of the pound spot rate and the 30-day forward rate for pounds on the next-to-last Thursday of the preceding month. The yearly average exchange rate was £1 = $0.90 for 2020, £1 = $1.00 for 2021, and £1 = $1.10 for 2022. The closing balance sheet of U.K. Branch in 2021 reflected the following assets:

(A) £100;

(B) A sales office purchased in 2020 with an adjusted basis of £1,000;

(C) A delivery truck purchased in 2020 with an adjusted basis of £200;

(D) Inventory of 100 units purchased in 2021 with a basis of £100; and

(E) Stock in ABC Corporation purchased in 2021 with a basis of £150, representing less than 10 percent of the total voting power and value of all classes of stock of ABC Corporation.

The closing balance sheet of U.K. Branch for 2021 reflected one liability, £50 of long-term debt entered into in 2020 with F Bank, an unrelated bank.

The office, truck, stock, and inventory are historic assets (as defined in § 1.987–1(e)). The £100 and long-term debt are marked items (as defined in § 1.987–1(d)). Assume that U.S. Corp translated U.K. Branch's 2021 closing balance sheet as follows:

Assets	***Amount in £***	***Translation Rate***	***Amount in $***
Pounds	£100.00	£1 = $1.05 (convention rate-Dec. 2021)	$105.00
Office	1,000.00	£1 = $0.90 (historic rate-2020)	900.00
Truck	200.00	£1 = $0.90 (historic rate-2020)	180.00
Stock	50.00	£1 = $1.00 (historic rate-2021)	150.00
Inventory	100.00	£1 = $1.00 (historic rate-2021)	100.00
Total assets			$1435.00
Liabilities			
Bank Loan	£50.00	£1 = $1.05 (convention rate-Dec. 2021)	$52.50
Total liabilities			$52.50
2021 ending OFCNV			$1,382.50

(ii) U.K. Branch uses the first-in, first-out (FIFO) method of accounting for inventory. In 2022, U.K. Branch sold 100 units of inventory for a total of £300 and purchased another 100 units of inventory for £100. There is depreciation of £33 with respect to the office and £40 with respect to the truck, and U.K. Branch incurred £30 of business expenses during 2022. Neither the depreciation nor the business expenses are inventoriable costs. All items of income earned and expenses incurred during 2022 are received and paid, respectively, in pounds. Under § 1.987–3, U.K. Branch's section 987 taxable income or loss is determined as follows:

Item	***Amount in £***	***Translation Rate***	***Amount in $***
Gross receipts	£300.00	£1 = $1.10 (yearly average rate-2022)	$330.00
Less: COGS	(100.00)	£1 = $1.00 (historic rate-2021)	*(100.00)*
Gross income			$230.00

Item	***Amount in £***	***Translation Rate***	***Amount in $***
Dep: Office	(33.00)	£1 = $0.90 (historic rate-2020)	($29.70)
Truck	(40.00)	£1 = $0.90 (historic rate-2020)	(36.00)
Other expenses	(30.00)	£1 = $1.10 (yearly average rate-2022)	*(33.00)*
Total expenses			($98.70)
Section 987 taxable income	$131.30		

Accordingly, U.K. Branch has $131.30 of section 987 taxable income in 2022.

(iii) In December 2022, U.K. Branch transferred £30 to U.S. Corp, and U.S. Corp transferred a computer with a basis of $10 to U.K. Branch. U.S. Corp's net accumulated unrecognized section 987 gain or loss for all prior taxable years as determined in paragraph (c) of this section is $30.

(iv) The unrecognized section 987 gain or loss of U.K. Branch for 2022 is determined as follows:

(A) *Step 1*. Under paragraph (d)(1) of this section, the change in OFCNV for the taxable year must be determined. This amount is equal to the OFCNV of U.K. Branch determined under paragraph (e) of this section on the last day of 2022, less the OFCNV of U.K. Branch determined on the last day of 2021. The OFCNV of U.K. Branch on December 31, 2022, and the change in OFCNV for 2022, are determined as follows:

Assets	***Amount in £***	***Translation Rate***	***Amount in $***
Pounds	£240.00	£1 = $1.15 (convention rate-Dec. 2022)	$276.00
Office	967.00	£1 = $0.90 (historic rate-2020)	870.30
Truck	160.00	£1 = $0.90 (historic rate-2020)	144.00
Inventory	100.00	£1 = $1.10 (historic rate-2022)	110.00
Computer	9.09	£1 = $1.10 (historic rate-2022)	10.00
Stock	150.00	£1 = $1.00 (historic rate-2021)	150.00
Total assets			$1,560.30
Liabilities			

Assets	***Amount in £***	***Translation Rate***	***Amount in $***
Bank Loan	£50.00	£1 = $1.15 (convention rate-Dec. 2022)	*$57.50*
Total liabilities			$57.50
2022 ending OFCNV			$1,502.80
Less: 2021 ending OFCNV			(1,382.50)
Change in OFCNV			$120.30

(B) *Step 2*. Under paragraph (d)(2) of this section, the aggregate amount determined in step 1 must be increased by the total amount of assets described in paragraph (d)(2)(ii) of this section transferred from U.K. Branch to U.S. Corp during the taxable year, translated into U.S. Corp's functional currency as provided in paragraph (d)(2)(ii) of this section. The amount of assets transferred from U.K. Branch to U.S. Corp during 2022 is determined as follows:

Asset	***Amount in £***	***Translation Rate***	***Amount in $***
£30	£30.00	£1 = $1.15 (convention rate-Dec. 2022)	$34.50

(C) *Step 3: Decrease the aggregate amount described in steps 1 and 2 by the owner's transfers to the section 987 QBU*. Under paragraph (d)(3) of this section, the aggregate amount determined in steps 1 and 2 must be decreased by the total amount of all assets transferred from U.S. Corp to U.K. Branch during the taxable year as determined in paragraph (d)(3)(ii) of this section. The amount of assets transferred from U.S. Corp to U.K. Branch during 2022 is determined as follows:

Asset	***Amount in $***
Computer	$10.00

(D) *Step 4*. Under paragraph (d)(4) of this section, the aggregate amount determined in steps 1 through 3 must be decreased by the aggregate amount of liabilities transferred by U.K. Branch to U.S. Corp. Under these facts, such amount is $0.

(E) *Step 5*. Under paragraph (d)(5) of this section, the aggregate amount determined in steps 1 through 4 must be increased by the aggregate amount of liabilities transferred by U.S. Corp to U.K. Branch. Under these facts, such amount is $0.

(F) *Step 6*. Under paragraph (d)(6) of this section, the aggregate amount determined in steps 1 through 5 is decreased or increased, respectively, by any section 987 taxable income or loss of U.K. Branch computed under § 1.987–3 for the taxable year. The amount of U.K. Branch's taxable income, as determined above, is $131.30.

(H) *Steps 7 and 8*: Paragraphs (d)(7) and (d)(8) do not apply because U.K. Branch does not have any tax-exempt income or nondeductible expense.

(v) *Summary*. Taking steps 1 through 8 into account, the amount of U.S. Corp's unrecognized section 987 gain or loss with respect to U.K. Branch in 2022 is computed as follows:

Step	***Amount in $***	***Balance***
1	+$120.30	$120.30
2	+34.50	154.80
3	-10.00	144.80
4	-0	144.80
5	+0	144.80
6	-131.30	13.50
7	+0	13.50
8	-0	13.50

Thus, U.S. Corp's unrecognized section 987 gain for 2022 with respect to U.K. Branch is $13.50. As of the end of 2022, before taking into account the recognition of any section 987 gain or loss under § 1.987–5, U.S. Corp's net unrecognized section 987 gain is $43.50 (that is, $30.00 accumulated from prior years, plus $13.50 in 2022).

Example 3. (i) *Background*. U.S. Corp is the owner of Business A, a section 987 QBU that has the euro as its functional currency. Business A uses the FIFO method to account for inventory and uses the simplified inventory method described in § 1.987–3(c)(2)(iv)(A). On the last day of 2020, U.S. Corp begins Business A by contributing to Business A a building with a basis of $780, a machine with a basis of $300, and $100. On January 1, 2021, Business A converts the $100 into €100. The tax basis of the building and machine is translated into euros using the historic rate, which is the yearly average exchange rate for 2020, the year of the transfer. Accordingly, the building and the machine have a tax basis of €780 and €300, respectively, on December 31, 2020. The building and machine have annual depreciation of €20 and €30, respectively. Business A determines that 50 percent of the building depreciation should be allocated to the cost of goods manufactured (that is, treated as an inventoriable cost) and 50 percent should be allocated to selling, general and

administrative (SG&A) expenses. The machine is used exclusively to manufacture inventory. Relevant exchange rates for purposes of this example are as follows:

Year	***Yearly Average Exchange Rate***	***December 31 Spot Rate***
2020	€1 = $1.00	€1 = $1.00
2021	€1 = $1.50	€1 = $2.00
2022	€1 = $2.50	€1 = $3.00

(ii) *Operations in 2021*. During 2021, Business A recognizes €140 of revenue from sales of finished goods. The related COGS is €70. Business A pays €10 in salaries allocable to SG&A. Inventoriable costs in 2021 include €10 of depreciation on the building and €30 of depreciation on the machine. Business A's balance sheet on December 31, 2021, shows no liabilities and the following assets: currency of €160, the building with an adjusted basis of €760, the machine with an adjusted basis of €270, and ending inventory with a FIFO cost basis of €40, comprising raw materials and finished goods.

(A) *Determination of income*. Under the simplified inventory method, Business A's income for 2021 is computed as follows:

Item	***Amount in €***	***Translation Rate***	***Amount in $***
Sales revenue	€140	€1 = $1.50 (yearly avg. rate-2021)	$210
COGS before adjustments	70	€1 = $1.50 (yearly avg. rate-2021)	$105
Adjustment for cost recovery deductions (see calculation below)			(20)
Adjustment for beginning inventory (none)			0
Adjusted COGS			$85
SG&A			
Depreciation on building (50%)	10	€1 = $1.00 (historic rate-2020)	$10
Salaries	10	€1 = $1.50 (yearly avg. rate-2021)	*15*
Total SG&A			$25

Item	***Amount in €***	***Translation Rate***	***Amount in $***
Section 987 net income (revenue less COGS and SG&A)			$100

COGS Adjustments				
Adjustment for cost recovery deductions included in inventoriable costs				
Depreciation	*Historic*	*2021*	*Difference in*	*Adjustment*
Amount	*Rate*	*Yearly Avg.*	*Translation*	*(Depreciation x*
		Rate	*Rates*	*Change in Rates)*
€10 (building)	1.00	1.50	(0.50)	($5)
€30 (machine)	1.00	1.50	(0.50)	*($15)*
Total adjustment for cost recovery deductions				($20)

(B) *Determination of OFCNV for 2020 and 2021*.

Under the simplified inventory method, the OFCNV of Business A for 2020 and 2021 is determined under paragraph (e) of this section as follows:

OFCNV-End of 2021			
Assets	***Amount in €***	***Translation Rate***	***Amount in $***
Euros	€160	€1 = $2.00 (year-end spot rate-2021)	$320
Building	760	€1 = $1.00 (historic rate-2020)	760
Machine	270	€1 = $1.00 (historic rate-2020)	270
Inventory	40	€1 = $1.50 (yearly average rate-2021)	60
Total assets			$1,410

OFCNV-End of 2021			
Assets	***Amount in €***	***Translation Rate***	***Amount in $***
Liabilities			
Total liabilities			$0
2021 ending OFCNV			$1,410

OFCNV-End of 2020			
Assets	***Amount in €***	***Translation Rate***	***Amount in $***
Euros	€100	€1 = $1.00 (year-end spot rate-2020)	$100
Building	780	€1 = $1.00 (historic rate-2020)	780
Machine	300	€1 = $1.00 (historic rate-2020)	*300*
Total assets			$1,180
Liabilities			
Total liabilities			$0
2020 ending OFCNV			$1,180

(C) *Determination of net unrecognized section 987 gain or loss*. The net unrecognized section 987 gain or loss of Business A is determined under paragraph (d) of this section as follows (relevant steps only):

(*1*) *Step 1*. Under paragraph (d)(1) of this section, the change in OFCNV for the taxable year must be determined. This amount is equal to the OFCNV of Business A determined under paragraph (e) of this section on the last day of 2021, less the OFCNV of Business A determined on the last day of 2020.

2021 ending OFCNV	$1,410
Less: 2020 ending OFCNV	*(1,180)*
Change in OFCNV	$230

(*2*) *Step 6*. Under paragraph (d)(6) of this section, the aggregate amount determined in steps 1 through 5 must be decreased by the section 987 taxable income of Business A. The amount of Business A's taxable income for 2021, as determined above, is $100.

Change in OFCNV	$230
Less: section 987 taxable income	*(100)*
Unrecognized section 987 gain	$130
Plus: net accumulated unrecognized	
section 987 gain or loss from prior years	*0*
Net unrecognized section 987 gain	$130

(iii) *Operations in 2022*. During 2022, Business A recognizes €180 of revenue from sales of finished goods. The related COGS is €96. Business A pays €10 in salaries allocable to SG&A. Inventoriable costs in 2022 include €30 of depreciation on the machine and €10 of depreciation on the building. Business A's balance sheet on December 31, 2022, shows no liabilities and the following assets: currency of €260, the building with an adjusted basis of €740, the machine with an adjusted basis of €240, and ending inventory with a FIFO cost basis of €54, comprising raw materials and finished goods.

(A) *Determination of income*. Under the simplified inventory method, Business A's income for 2022 is computed as follows:

Item	***Amount in €***	***Translation Rate***	***Amount in $***
Sales revenue	€180	€1 = $2.50 (yearly avg. rate-2022)	$450
COGS before adjustments	96	€1 = $2.50 (yearly avg. rate-2022)	$240
Adjustment for cost recovery deductions (see calculation below)			(60)
Adjustment for beginning inventory (see calculation below)			*(40)*
Adjusted COGS			$140
SG&A			
Depreciation on building (50%)	10	€1 = $1.00 (historic rate-2020)	$10

Item	***Amount in €***	***Translation Rate***	***Amount in $***
Salaries	10	€1 = $2.50 (yearly avg. rate-2022)	25
Total SG&A			$35
Section 987 net income (revenue less COGS and SG&A)			$275

COGS Adjustments				
Adjustment for cost recovery deductions				
Depreciation	*Historic*	*2022*	*Difference in*	*Adjustment*
Amount	*Rate*	*Yearly Avg.*	*Translation*	*(Depreciation x*
		Rate	*Rates*	*Change in Rates)*
€10 (building)	1.00	2.50	(1.50)	($15)
€30 (machine)	1.00	2.50	(1.50)	*($45)*
Total adjustment for cost recovery deductions				($60)

Adjustment for beginning inventory				
Prior Year Ending	*2021*	*2022*	*Difference in*	*Adjustment*
Inventory	*Yearly Avg.*	*Yearly Avg.*	*Translation*	*(Inventory x*
	Rate	*Rate*	*Rates*	*Change in Rates)*
€40	1.50	2.50	(1.00)	*($40)*
Total adjustment for beginning inventory				($40)

(B) *Determination of OFCNV*. Under the simplified inventory method, the OFCNV of Business A for 2022 is determined under paragraph (e) of this section as follows:

OFCNV-End of 2022			
Assets	***Amount in €***	***Translation Rate***	***Amount in $***
Euros	€260	€1 = $3.00 (year-end spot rate-2022)	$780
Building	740	€1 = $1.00 (historic rate-2020)	740
Machine	240	€1 = $1.00 (historic rate-2020)	240
Inventory	54	€1 = $2.50 (yearly average rate-2022)	*135*
Total assets			$1,895
Liabilities			
Total liabilities			$0
2022 ending OFCNV			$1,895

(C) *Determination of net unrecognized section 987 gain or loss*. The net unrecognized section 987 gain of Business A is determined under paragraph (d) of this section as follows (relevant steps only):

(*1*) *Step 1*. Under paragraph (d)(1) of this section, the change in OFCNV for the taxable year must be determined. This amount is equal to the OFCNV of Business A determined under paragraph (e) of this section on the last day of 2022, less the OFCNV of Business A determined on the last day of 2021.

2022 ending OFCNV	$1,895
Less: 2021 ending OFCNV	*(1,410)*
Change in OFCNV	$485

(*2*) *Step 6*. Under paragraph (d)(6) of this section, the aggregate amount determined in steps 1 through 5 must be decreased by the section 987 taxable income of Business A. The amount of Business A's taxable income for 2022, as determined above, is $275.

Change in OFCNV	$485
Less: section 987 taxable income	*(275)*

Unrecognized section 987 gain 2022	$210
Plus: net accumulated unrecognized section 987 gain from prior year	*130*
Net unrecognized section 987 gain	$340

Example 4. (i) *Background*. The background facts about Business A are the same as in *Example 3*, except that Business A uses the dollar-value LIFO method to account for inventory.

(ii) *Operations in 2021*. The facts about Business A's operations in 2021 are the same as in *Example 3*.

(A) *Determination of income*. Under the simplified inventory method, Business A's income for 2021 is computed as follows:

Item	***Amount in €***	***Translation Rate***	***Amount in $***
Sales revenue	€140	€1 = $1.50 (yearly avg. rate-2021)	$210
COGS before adjustments	70	€1 = $1.50 (yearly avg. rate-2021)	$105
Adjustment for cost recovery deductions (same as *Example 1*)			(20)
Adjustment for LIFO liquidation (none)			*0*
Adjusted COGS			$85
SG&A			
Depreciation on building (50%)	10	€1 = $1.00 (historic rate-2020)	$10
Salaries	10	€1 = $1.50 (yearly avg. rate-2021)	*15*
Total SG&A			$25
Section 987 net income (revenue less COGS and SG&A)			$100

(B) *Determination of OFCNV for 2020 and 2021*. Under the simplified inventory method, the OFCNV of Business A for 2020 and 2021 is determined under paragraph (e) of this section as follows:

OFCNV-End of 2021

OFCNV-End of 2021			
Assets	***Amount in €***	***Translation Rate***	***Amount in $***
Assets	***Amount in €***	***Translation Rate***	***Amount in $***
Euros	€160	€1 = $2.00 (year-end spot rate-2021)	$320
Building	760	€1 = $1.00 (historic rate-2020)	760
Machine	270	€1 = $1.00 (historic rate-2020)	270
Inventory	40	€1 = $1.50 (historic rate-2021)	*60*
Total assets			$1,410
Liabilities			
Total liabilities			$0
2021 ending OFCNV			$1,410

OFCNV-End of 2020			
Assets	***Amount in €***	***Translation Rate***	***Amount in $***
Euros	€100	€1 = $1.00 (year-end spot rate-2020)	$100
Building	780	€1 = $1.00 (historic rate-2020)	780
Machine	300	€1 = $1.00 (historic rate-2020)	*300*
Total assets			$1,180
Liabilities			
Total liabilities			$0
2020 ending OFCNV			$1,180

(C) *Determination of net unrecognized section 987 gain or loss*. The net unrecognized section 987 gain or loss of Business A for 2021 is determined under paragraph (d) of this section as follows (relevant steps only):

(*1*) *Step 1*. Under paragraph (d)(1) of this section, the change in OFCNV for the taxable year must be determined. This amount is equal to the OFCNV of Business A determined under paragraph (e) of this section on the last day of 2021, less the OFCNV of Business A determined on the last day of 2020.

2021 ending OFCNV	$1,410
Less: 2020 ending OFCNV	*(1,180)*
Change in OFCNV	$230

(*2*) *Step 6*. Under paragraph (d)(6) of this section, the aggregate amount determined in steps 1 through 5 must be decreased by the section 987 taxable income of Business A. The amount of Business A's taxable income for 2021, as determined above, is $100.

Change in OFCNV	$230
Less: section 987 taxable income	*(100)*
Unrecognized section 987 gain	$130
Plus: Net accumulated unrecognized	
section 987 gain or loss from prior years	*0*
Net unrecognized section 987 gain	$130

(iii) *Operations in 2022*. The facts about Business A's operations in 2022 are the same as in *Example 3*, except that due to Business A's dollar-value LIFO method of inventory accounting, Business A's balance sheet on December 31, 2022, reflects a 2021 layer of inventory with a LIFO cost basis of €40 and a 2022 layer of inventory with a LIFO cost basis of €10.80, and Business A's COGS is €99.20.

(A) *Determination of income*. Business A's income for 2022 is computed as follows:

Item	***Amount in €***	***Translation Rate***	***Amount in $***
Sales revenue	€180	€1 = $2.50 (yearly avg. rate-2022)	$450
COGS before adjustments	99.20	€1 = $2.50 (yearly avg. rate-2022)	$248
Adjustment for cost recovery deductions (same as *Example 3*)			(60)
Adjustment for LIFO liquidation (none)			*0*
Adjusted COGS			$188
SG&A			

Item	***Amount in €***	***Translation Rate***	***Amount in $***
Depreciation on building (50%)	10	€1 = $1.00 (historic rate-2020)	$10
Salaries	10	€1 = $2.50 (yearly avg. rate-2022)	*25*
Total SG&A			$35
Section 987 net income (revenue less COGS and SG&A)			$227

	OFCNV-End of 2022		
Assets	***Amount in €***	***Translation Rate***	***Amount in $***
Euros	€260.00	€1 = $3.00 (year-end spot rate-2022)	$780
Building	740.00	€1 = $1.00 (historic rate-2020)	740
Machine	240.00	€1 = $1.00 (historic rate-2020)	240
Inventory	10.80	€1 = $2.50 (historic rate-2022)	27
	40.00	€1 = $1.50 (historic rate-2021)	*60*
Total assets			$1,847
Liabilities			
Total liabilities			$0
2022 ending OFCNV			$1,847

(B) *Determination of net unrecognized section 987 gain or loss*. The net unrecognized section 987 gain of Business A for 2022 is determined under paragraph (d) of this section as follows (relevant steps only):

(*1*) *Step 1*. Under paragraph (d)(1) of this section, the change in OFCNV for the taxable year must be determined. This amount is equal to the OFCNV of Business A determined under paragraph (e) of this section on the last day of 2022, less the OFCNV of Business A determined on the last day of 2021.

2022 ending OFCNV	$1,847
Less: 2021 ending OFCNV	*(1,410)*

Change in OFCNV	$437

(*2*) *Step 6—Decrease the aggregate amount determined in steps 1 through 5 by the section 987 taxable income of the section 987 QBU for the taxable year*. Under paragraph (d)(6) of this section, the aggregate amount determined in steps 1 through 5 must be decreased by the section 987 taxable income of Business A. The amount of Business A's taxable income for 2022, as determined above, is $227.

Change in OFCNV	$437
Less: section 987 taxable income	*(227)*
Unrecognized section 987 gain 2022	$210
Plus: net accumulated unrecognized section 987 gain from prior years	*130*
Net unrecognized section 987 gain	$340

(iv) *Operations in 2023*. During 2023, Business A recognizes revenue of €252 from sales of finished goods. The related COGS is €140.80, reflecting a full liquidation of the 2022 inventory layer with a LIFO cost basis of $10.80 and a partial liquidation of inventory from the 2021 layer with a LIFO cost basis of $10.00. Business A pays €10 in salaries allocable to SG&A. Inventoriable costs in 2023 include €10 of depreciation on the building and €30 of depreciation on the machine. Business A's balance sheet on December 31, 2023, shows no liabilities and the following assets: currency of €422, the building with an adjusted basis of €720, the machine with an adjusted basis of €210, and a 2021 layer of ending inventory with a LIFO cost basis of €30, comprising raw materials and finished goods. The yearly average exchange rate for 2023 is €1 = $3.50, and the spot rate on December 31, 2023 is €1 = $4.00.

(A) *Determination of income*. Business A's income for 2023 is computed as follows:

Item	***Amount in €***	***Translation Rate***	***Amount in $***
Sales revenue	€252	€1 = $3.50 (yearly avg. rate-2023)	$882
COGS before adjustments	140.80	€1 = $3.50 (yearly avg. rate-2023)	$492.80
Adjustment for cost recovery deductions (see calculation below)			(100.00)
Adjustment for LIFO liquidation (see calculation below)			*(30.80)*

Item	***Amount in €***	***Translation Rate***	***Amount in $***
Adjusted COGS			$362.00
SG&A			
Depreciation on building (50%)	10	€1 = $1.00 (historic rate-2020)	$10
Salaries	10	€1 = $3.50 (yearly avg. rate-2023)	*35*
Total SG&A			$45
Section 987 net income			$475

COGS Adjustments				
Adjustment for cost recovery deductions				
Depreciation	*Historic*	*2023*	*Difference in*	*Adjustment*
Amount	*Rate*	*Yearly Avg.*	*Translation*	*(Depreciation x*
		Rate	*Rates*	*Change in Rates)*
€10 (building)	1.00	3.50	(2.50)	($25)
€30 (machine)	1.00	3.50	(2.50)	*($75)*
Total adjustment for cost recovery deductions				($100)

Adjustment for LIFO liquidation				
LIFO Liquidation	*Historic*	*2023*	*Difference in*	*Adjustment*
Layer	*Rate*	*Yearly Avg.*	*Translation*	*(Liquidated Layer x*
		Rate	*Rates*	*Change in Rates)*
€10.80 (2022)	2.50	3.50	(1.00)	($10.80)

Adjustment for LIFO liquidation				
€10 (2021)	1.50	3.50	(2.00)	*($20.00)*
Total adjustment for liquidation of LIFO layers				($30.80)

(B) *Determination of OFCNV*. The OFCNV of Business A for 2023 is determined under paragraph (e) of this section as follows:

OFCNV-End of 2023			
Assets	***Amount in €***	***Translation Rate***	***Amount in $***
Euros	€422	€1 = $4.00 (year-end spot rate-2023)	$1,688
Building	720	€1 = $1.00 (historic rate-2020)	720
Machine	210	€1 = $1.00 (historic rate-2020)	210
Inventory	30	€1 = $1.50 (historic rate-2021)	*45*
Total assets			$2,663
Liabilities			
Total liabilities			$0
2023 ending OFCNV			$2,663

(C) *Determination of net unrecognized section 987 gain or loss*. The net unrecognized section 987 gain of Business A is determined under paragraph (d) of this section as follows (relevant steps only):

(*1*) *Step 1*. Under paragraph (d)(1) of this section, the change in OFCNV for the taxable year must be determined. This amount is equal to the OFCNV of Business A determined under paragraph (e) of this section on the last day of 2023, less the OFCNV of Business A determined on the last day of 2022.

2023 ending OFCNV	$2,663
Less: 2022 ending OFCNV	*(1,847)*
Change in OFCNV	$816

(*2*) *Step 6—Decrease the aggregate amount determined in steps 1 through 5 by the section 987 taxable income of the section 987 QBU for the taxable year*. Under paragraph (d)(6) of this section, the aggregate amount determined in steps 1

through 5 must be decreased by the section 987 taxable income of Business A. The amount of Business A's taxable income for 2023, as determined above, is $475.

Change in OFCNV	$816
Less: section 987 taxable income	*(475)*
Unrecognized section 987 gain 2023	$341
Plus: net accumulated unrecognized section 987 gain from prior years	*340*
Net unrecognized section 987 gain	$681

§ 1.987–5 Recognition of section 987 gain or loss.

(a) *Recognition of section 987 gain or loss by the owner of a section 987 QBU*. The taxable income of an owner of a section 987 QBU shall include the owner's section 987 gain or loss recognized with respect to the section 987 QBU for the taxable year. Except as otherwise provided, for any taxable year the owner's section 987 gain or loss recognized with respect to a section 987 QBU shall equal:

(1) The owner's net unrecognized section 987 gain or loss with respect to the section 987 QBU determined under § 1.987–4 on the last day of such taxable year (or, if earlier, on the day the section 987 QBU is terminated under § 1.987–8); multiplied by

(2) The owner's remittance proportion for the taxable year, as determined under paragraph (b) of this section.

(b) *Remittance proportion*. The owner's remittance proportion with respect to a section 987 QBU for a taxable year shall equal:

(1) The remittance, as determined under paragraph (c) of this section, to the owner from the section 987 QBU for such taxable year; divided by

(2) The sum of

(A) The aggregate adjusted basis of the gross assets of the section 987 QBU as of the end of the taxable year that are reflected on its year-end balance sheet translated into the owner's functional currency as provided in § 1.987–4(e)(2) and

(B) The amount of the remittance as determined under paragraph (c) of this section.

(c) *Remittance*—(1) *Definition*. A remittance shall be determined in the owner's functional currency and shall equal the excess, if any, of:

(i) The aggregate of all amounts transferred from the section 987 QBU to the owner during the taxable year, as determined in paragraph (d) of this section; over

(ii) The aggregate of all amounts transferred from the owner to the section 987 QBU during the taxable year, as determined in paragraph (e) of this section.

(2) *Day when a remittance is determined*. An owner's remittance from a section 987 QBU shall be determined on the last day of the owner's taxable year (or, if earlier, on the day the section 987 QBU is terminated under § 1.987–8).

(3) *Termination*. A termination of a section 987 QBU as determined under § 1.987–8 is treated as a remittance of all the gross assets of the section 987 QBU to the owner on the date of such termination. See § 1.987–8(e). Accordingly, the remittance proportion in the case of a termination is 1.

(d) *Aggregate of all amounts transferred from the section 987 QBU to the owner for the taxable year*. For purposes of paragraph (c)(1)(i) of this section, the aggregate amount transferred from the section 987 QBU to the owner for the taxable year shall be the aggregate amount of functional currency and the aggregate adjusted basis of the assets transferred, as determined in the owner's functional currency under § 1.987–4(d)(2). Solely for this purpose, the amount of liabilities transferred from the owner to the section 987 QBU, as determined in the owner's functional currency under § 1.987–4(d)(5), shall be treated as a transfer of assets from the section 987 QBU to the owner in an amount equal to the amount of such liabilities.

(e) *Aggregate of all amounts transferred from the owner to the section 987 QBU for the taxable year*. For purposes of paragraph (c)(1)(ii) of this section, the aggregate of all amounts transferred from the owner to the section 987 QBU for the taxable year shall be the aggregate amount of functional currency and the aggregate adjusted basis of the assets transferred, as determined in the owner's functional currency under § 1.987–4(d)(3). Solely for this purpose, the amount of liabilities transferred from the section 987 QBU to the owner determined under § 1.987–4(d)(4) shall be treated as a transfer of assets from the owner to the section 987 QBU in an amount equal to the amount of such liabilities.

(f) *Determination of owner's adjusted basis in transferred assets*—(1) *In general*. The owner's adjusted basis in an asset received in a transfer from a section 987 QBU (whether or not such transfer is made in connection with a remittance, as defined in paragraph (c) of this section) shall be determined in the owner's functional currency under the rules prescribed in paragraphs (f)(2) and (f)(3) of this section.

(2) *Marked asset*. The basis of a marked asset shall be the amount determined by translating the section 987 QBU's functional currency basis of the asset, after taking into account § 1.988–1(a)(10), into the owner's functional currency at the spot rate (as defined in § 1.987–1(c)(1)) applicable to the date of transfer.

(3) *Historic asset*. The basis of a historic asset shall be the amount determined by translating the section 987 QBU's functional currency basis of the asset, after taking into account § 1.988–1(a)(10), into the owner's functional currency at the historic rate for the asset (as defined in § 1.987–1(c)(3)).

(g) *Example.* The following example illustrates the calculation of section 987 gain or loss under this section:

Example. (i) U.S. Corp, a domestic corporation with the dollar as its functional currency, operates in the United Kingdom through Business A, a section 987 QBU with the pound as its functional currency. During 2021, the following transfers took place between U.S. Corp and Business A. On January 5, 2021, U.S. Corp transferred to Business A $300, which Business A used during the year to purchase services. On March 5, 2021, Business A transferred a machine to U.S. Corp. The pound adjusted basis of the machine when properly translated into dollars as described under § 1.987–4(d)(2)(ii)(B) and paragraph (d) of this section is $500. On November 1, 2021, Business A transferred pounds to U.S. Corp. The dollar amount of the pounds when properly translated as described under § 1.987–4(d)(2)(ii)(A) and paragraph (d) of this section is $2,300. On December 7, 2021, U.S Corp transferred a truck to Business A with an adjusted basis of $2,000.

(ii) At the end of 2021, Business A holds assets, properly translated into the owner's functional currency pursuant to § 1.987–4(e)(2), consisting of a computer with a pound adjusted basis equivalent to $500, a truck with a pound adjusted basis equivalent to $2,000, and pounds equivalent to $2,850. In addition, Business A has a pound liability entered into in 2020 with Bank A. All such assets and liabilities are reflected on the books and records of Business A. Assume that the net unrecognized section 987 gain for Business A as determined under § 1.987–4 as of the last day of 2021 is $80.

(iii) U.S. Corp's section 987 gain with respect to Business A is determined as follows:

(A) *Computation of amount of remittance*. Under paragraphs (c)(1) and (c)(2) of this section, U.S. Corp must determine the amount of the remittance for 2021 in the owner's functional currency (dollars) on the last day of 2021. The amount of the remittance for 2021 is $500, determined as follows:

Transfers from Business A to U.S. Corp in dollars:	
Machine	$500
Pounds	*2,300*
Aggregate transfers from Business A to U.S. Corp	$2,800
Transfers from U.S. Corp to Business A in dollars:	
U.S. dollars	$300
Truck	*2,000*
Aggregate transfers from U.S. Corp to Business A	$2,300
Computation of amount of remittance:	

Transfers from Business A to U.S. Corp in dollars:	
Aggregate transfers from Business A to U.S. Corp	$2,800
Less: aggregate transfers from U.S. Corp to Business A	*(2,300)*
Total remittance	$500

(B) *Computation of section 987 QBU gross assets plus remittance*. Under paragraph (b)(2) of this section, Business A must determine the aggregate basis of its gross assets that are reflected on its year-end balance sheet translated into the owner's functional currency and must increase this amount by the amount of the remittance.

Computer	$500
Pounds	2,850
Truck	*2,000*
Aggregate gross assets	$5,350
Remittance	$500
Aggregate basis of Business A's gross assets at end of 2021, increased by amount of remittance	$5,850

(C) *Computation of remittance proportion*. Under paragraph (b) of this section, Business A must compute the remittance proportion by dividing the $500 remittance amount by the $5,850 sum of the aggregate basis of Business A's gross assets and the amount of the remittance. The resulting remittance proportion is 0.085.

(D) *Computation of section 987 gain or loss*. The amount of U.S. Corp's section 987 gain or loss that must be recognized with respect to Business A is determined under paragraph (a) of this section by multiplying the 0.085 remittance proportion by the $80 of net unrecognized section 987 gain. U.S. Corp's resulting recognized section 987 gain for 2021 is $6.80.

Par. 5 Sections 1.987–6 through 1.987–11 are added to read as follows:

* * * * *

Sec.

1.987–6 Character and source of section 987 gain or loss.

1.987–7 Section 987 aggregate partnerships.

1.987–8 Termination of a section 987 QBU.

1.987–9 Recordkeeping requirements.

1.987–10 Transition rules.

1.987–11 Effective/applicability date.

* * * * *

§ 1.987–6 Character and source of section 987 gain or loss.

(a) *Ordinary income or loss.* Section 987 gain or loss is ordinary income or loss for Federal income tax purposes.

(b) *Character and source of section 987 gain or loss*—(1) *In general*. With respect to each section 987 QBU, the owner must determine the character and source of section 987 gain or loss in the year of a remittance under the rules of this paragraph (b) for all purposes of the Internal Revenue Code, including sections 904(d), 907, and 954.

(2) *Method required to characterize and source section 987 gain or loss*. The owner must use the asset method set forth in § 1.861–9T(g) to characterize and source section 987 gain or loss. In applying the asset method, the owner must take into account only the assets of the section 987 QBU and must consistently determine the value of the assets on the basis of either the tax book value or the fair market value of the assets. The modified gross income method described in § 1.861–9T(j) cannot be used.

(3) *Coordination with section 954*. Solely for purposes of determining the excess of foreign currency gains over foreign currency losses characterized as foreign personal holding company income under section 954(c)(1)(D), section 987 gain or loss that is characterized pursuant to paragraph (b)(2) of this section by reference to assets that give rise to subpart F income shall be treated as foreign currency gain or foreign currency loss attributable to section 988 transactions not directly related to the business needs of the controlled foreign corporation.

(c) *Examples*. The following examples illustrate the application of this section.

Example 1. CFC is a controlled foreign corporation as defined in section 957 with the Swiss franc (Sf) as its functional currency. CFC is the owner of Business A, a section 987 QBU that has the euro as its functional currency. For the year 2021, CFC recognizes section 987 gain of Sf10,000 under § 1.987–5. Applying the rules of this section, Business A has average total assets of Sf1,000,000, which generate income as follows: Sf750,000 of assets that generate foreign source general limitation income under section 904(d)(1)(A), none of which is subpart F income under section 952; and Sf250,000 of assets that generate foreign source passive income under section 904(d)(1)(B), all of which is subpart F income. Under paragraph (b) of this section, Sf7,500 (Sf750,000/Sf1,000,000 x Sf10,000) of the section 987 gain will be characterized as foreign source general limitation income that is not subpart F income under section 952, and Sf2,500 (Sf250,000/Sf1,000,000 x Sf10,000) will be characterized as foreign source passive income that is characterized as foreign personal holding company income under section 954(c)(1)(D). All of the section 987 gain is treated as ordinary income.

Example 2. The facts are the same as in *Example 1* except that: (a) CFC recognizes section 987 loss of Sf40,000, Sf10,000 of which is characterized under paragraph (b) of this section by reference to assets that give rise to subpart F income; and (b) CFC otherwise has Sf12,000 of net foreign currency gain determined under § 1.954–2(g) that is taken into account in determining the excess of foreign currency gain over foreign currency losses characterized as foreign personal holding company income under section 954(c)(1)(D). Under paragraph (b)(3) of this section, the Sf10,000 section 987 loss characterized by reference to assets that give rise to subpart F income is treated as foreign currency loss attributable to section 988 transactions not directly related to the business needs of the controlled foreign corporation for purposes of determining the excess of foreign currency gains over foreign currency losses characterized as foreign personal holding company income under section 954(c)(1)(D). Accordingly, CFC will aggregate the Sf10,000 section 987 loss with the Sf12,000 net foreign currency gain and will have Sf2,000 of net foreign currency gain characterized as foreign personal holding company income under section 954(c)(1)(D).

§ 1.987–7 Section 987 aggregate partnerships.

(a) *In general.* This section provides rules for determining an owner's share of the assets and liabilities of an eligible QBU that is owned indirectly, as described in § 1.987–1(b)(4)(ii), through a section 987 aggregate partnership.

(b) [Reserved].

(c) *Coordination with subchapter K*. [Reserved].

§ 1.987–8 Termination of a section 987 QBU.

(a) *Scope*. This section provides rules regarding the termination of a section 987 QBU. Paragraph (b) of this section provides general rules for determining when a termination occurs. Paragraph (c) of this section provides exceptions to the general termination rules for certain transactions described in section 381(a). Paragraph (e) of this section describes certain effects of terminations. Paragraph (f) of this section contains examples that illustrate the principles of this section.

(b) *In general*. Except as provided in paragraph (c) of this section, a section 987 QBU terminates if the conditions described in one of paragraphs (b)(1) through (4) is satisfied.

(1) *Trade or business ceases*. A section 987 QBU ceases its trade or business. When a section 987 QBU ceases its trade or business is determined based on all the facts and circumstances, provided that an owner may continue to treat a section 987 QBU as a section 987 QBU for a reasonable period during the winding up of such trade or business, which period may in no event exceed two years from the date on which such QBU ceases its activities carried on for profit.

(2) *Substantially all assets transferred*. The section 987 QBU transfers substantially all (within the meaning of section 368(a)(1)(C)) of its assets to its owner. For purposes of this paragraph (b)(2), the amount of assets transferred from the section 987 QBU to its owner as a result of a transaction shall be reduced by the amount of assets transferred from the owner to the section 987 QBU pursuant to the same transaction. See Examples 2, 5, and 6 in paragraph (f) of this section.

(3) *Owner no longer a CFC*. A foreign corporation that is a controlled foreign corporation (as defined in section 957) that is the owner of a section 987 QBU ceases to be a controlled foreign corporation as a result of a transaction or series of transactions after which persons that were related to the corporation within the meaning of section 267(b) immediately before the transaction or series of transactions collectively own sufficient interests in the corporation such that the corporation would continue to be considered a controlled foreign corporation if such persons were United States shareholders within the meaning of section 951(b).

(4) *Owner ceases to exist*. The owner of the section 987 QBU ceases to exist (including in connection with a transaction described in section 381(a)).

(c) *Transactions described in section 381(a)*—(1) *Liquidations*. Notwithstanding paragraph (b) of this section, a termination does not occur when the owner of a section 987 QBU ceases to exist in a liquidation described in section 332, except in the following cases:

(i) The distributor is a domestic corporation and the distributee is a foreign corporation.

(ii) The distributor is a foreign corporation and the distributee is a domestic corporation.

(iii) The distributor and the distributee are both foreign corporations and the functional currency of the distributee is the same as the functional currency of the distributor's section 987 QBU.

(2) *Reorganizations*. Notwithstanding paragraph (b) of this section, a termination does not occur when the owner of the section 987 QBU ceases to exist in a reorganization described in section 381(a)(2), except in the following cases:

(i) The transferor is a domestic corporation and the acquiring corporation is a foreign corporation.

(ii) The transferor is a foreign corporation and the acquiring corporation is a domestic corporation.

(iii) The transferor is a controlled foreign corporation immediately before the transfer, the acquiring corporation is a foreign corporation that is not a controlled foreign corporation immediately after the transfer, and the acquiring corporation was related to the transferor within the meaning of section 267(b) immediately before the transfer.

(iv) The transferor and the acquiring corporation are foreign corporations and the functional currency of the acquiring corporation is the same as the functional currency of the transferor's section 987 QBU.

(d) [Reserved].

(e) *Effect of terminations*. A termination of a section 987 QBU as determined in this section is treated as a remittance of all the gross assets of the section 987 QBU to its owner immediately before the section 987 QBU terminates. Thus, except as otherwise provided in these regulations under section 987, a termination results in the recognition of any net unrecognized section 987 gain or loss of the section 987 QBU. See § 1.987–5(c)(3).

(f) *Examples*. The following examples illustrate the principles of this section. Except as otherwise provided, U.S. Corp is a domestic corporation that has the U.S. dollar as its functional currency, and Business A is a section 987 QBU.

Example 1. *Cessation of operations*. (i) *Facts*. U.S. Corp is the owner of Business A , a sales office of U.S. Corp in Country X. Business A ceases sales activities on December 31, 2021. During 2022, Business A sells all of the assets used in its sales activities and winds up its business, settling outstanding accounts.

(ii) *Analysis*. Business A's trade or business ceases on December 31, 2021. The cessation of Business A's trade or business causes a termination of the Business A section 987 QBU under paragraph (b)(1) of this section on December 31, 2021, unless U.S. Corp chooses to continue to treat Business A as a section 987 QBU until completion of the wind-up activities in 2022. If U.S. Corp chooses to continue to treat Business A as a section 987 QBU during the wind-up of Business A, Business A section 987 QBU would terminate under paragraph (b)(1) of this section upon completion of the wind-up in 2022.

Example 2. *Transfer of a section 987 QBU to a member of a consolidated group*. (i) *Facts*. U.S. Corp, the owner of Business A, transfers all the assets and liabilities of Business A to DS, a domestic corporation all of the stock of which is owned by U.S. Corp, in a transaction qualifying under section 351. U.S. Corp and DS are members of the same consolidated group.

(ii) *Analysis*. Pursuant to § 1.987–2(c)(2)(i) and (ii), as a result of the deemed exchange of the assets and liabilities of Business A for DS stock in a section 351 transaction, Business A is treated as transferring its assets and liabilities to U.S. Corp immediately before the transfer by U.S. Corp of the assets and liabilities to DS. Because a section 351 transaction is not a transaction described in section 381(a), the transfer of all of the assets of Business A to U.S. Corp causes a termination of the Business A section 987 QBU under paragraph (b)(2) of this section.

Example 3. *Cessation of controlled foreign corporation status*. (i) *Facts*. Foreign parent (FP) is a foreign corporation that owns all the stock of U.S. Corp, a domestic corporation. U.S. Corp owns all of the stock of FC, a controlled foreign corporation as defined in section 957. FC is the owner of Business A. FP

contributes cash to FC in exchange for FC stock representing 60 percent of the voting power and value of all FC stock. FC no longer constitutes a controlled foreign corporation after the capital contribution.

(ii) *Analysis*. Because FC ceases to qualify as a controlled foreign corporation as a result of a transaction after which persons that were related to FC within the meaning of section 267(b) immediately before the transaction collectively own sufficient interests in FC such that the FC would continue to be considered a controlled foreign corporation if such persons were United States shareholders within the meaning of section 951(b), the Business A section 987 QBU terminates pursuant to paragraph (b)(3) of this section.

Example 4. *Section 332 liquidation*. (i) *Facts*. U.S. Corp owns all of the stock of FC, a foreign corporation. FC is the owner of Business A. Pursuant to a liquidation described in section 332, FC transfers all of its assets and liabilities to U.S. Corp.

(ii) *Analysis*. FC's liquidation causes a termination of the Business A section 987 QBU as provided in paragraph (b)(4) of this section because FC ceases to exist as a result of the liquidation. The exception for certain section 332 liquidations provided under paragraph (c)(1) of this section does not apply because U.S. Corp is a domestic corporation and FC is a foreign corporation. See paragraph (c)(1)(ii) of this section.

Example 5. *Transfers to and from a section 987 QBU pursuant to the same transaction*. (i) *Facts*. U.S. Corp owns 100 percent of DC1 and DC2, each a domestic corporation. DC1 owns Entity A, a DE that conducts a business (Business A) in Country X that constitutes a section 987 QBU of DC1. DC2 subsequently contributes property to Entity A in exchange for a 95 percent interest in Entity A. The property DC2 contributes to Entity A is used in the business conducted by Business A and is reflected on its books and records as provided under § 1.987–2(b).

(ii) *Analysis*. (A) For general Federal income tax purposes, Entity A is converted to a partnership when DC2 contributes property to Entity A in exchange for a 95 percent interest in Entity A. DC2's contribution is treated as a contribution to a partnership in exchange for an ownership interest in the partnership. DC1 is treated as contributing all of Business A to the partnership in exchange for a partnership interest. See Rev. Rul. 99–5 (situation 2), (1999–1 CB 434) and § 601.601(d)(2) of this chapter. For purposes of this section, these deemed transactions are not taken into account. See § 1.987–2(c) and § 1.987–2(c)(10), Example 9.

(B) Under § 1.987–1(b)(5)(i), Entity A is converted to a section 987 aggregate partnership when DC2 contributes property to Entity A in exchange for a 95 percent interest in Entity A because DC1 and DC2 own all the interests in partnership capital and profits, DC1 and DC2 are related within the meaning of section 267(b), and the requirements of § 1.987–1(b)(5)(i)(B) are satisfied. Because DC2 is a partner in a section 987 aggregate partnership that owns

Business A and because DC2 and Business A have different functional currencies, DC2's portion of the Business A assets constitutes a section 987 QBU of DC2.

(C) As a result of the conversion of Entity A to a partnership, DC2 acquires an allocable share of 95 percent of the assets of Business A, as determined under § 1.987–7. Accordingly, under § 1.987–2(c)(5), DC2 is treated as contributing 95 percent of its contributed property to its Business A section 987 QBU. In addition, DC2 is treated as transferring 5 percent of the contributed property to DC1, and DC1 is subsequently treated as transferring that property to DC1's Business A section 987 QBU. In addition, 95 percent of the original (pre-conversion) assets of Business A cease being reflected on the books and records of DC1's section 987 QBU. Under § 1.987–2(b)(5), these amounts are treated as if they are transferred from DC1's section 987 QBU to DC1, and DC1 is treated as transferring these assets to DC2. DC2 is subsequently treated as transferring these assets to DC2's Business A section 987 QBU. The other 5 percent of the original (pre-conversion) assets are treated as remaining on the books and records of DC1's section 987 QBU and are not deemed to be transferred.

(D) For purposes of determining whether substantially all the assets of Business A were transferred from DC1's section 987 QBU as provided under paragraph (b)(2) of this section, the amount of assets transferred from Business A to DC1 under § 1.987–2(c) (95 percent of the assets held by Business A before the contribution by DC2) must be reduced by the 5 percent of the assets contributed by DC2, which were treated as transferred from DC2 to DC1 and subsequently transferred from DC1 to its Business A section 987 QBU, as a result of the formation of the section 987 aggregate partnership. Accordingly, the amount of assets transferred from DC1's section 987 QBU for purposes of paragraph (b)(2) of this section is equal to 95 percent of the original (pre-conversion) assets minus 5 percent of DC2's contributed assets.

Example 6. *Deemed transfers to a CFC upon a check-the-box election*. (i) *Facts*. In 2021, U.S. Corp forms an entity in a foreign country, Entity A. Entity A owns Business A, which has the pound as its functional currency. Entity A forms Entity B in another foreign country. Entity B owns Business B, a section 987 QBU that has the euro as its functional currency. At the time of formation, Entity A and Entity B elect to be DEs. In 2026, Entity A files an election on Form 8832 to be classified as a corporation under § 301.7701–3(g)(1)(iv) and becomes a CFC (FC) owned directly by U.S. Corp. FC has the pound as its functional currency.

(ii) *Analysis*. (A) Under § 1.987–1(b)(4)(i), U.S. Corp is the owner of Business A and Business B. In 2026, when Entity A elects to be classified as a corporation, U.S. Corp is deemed to contribute the assets and liabilities of Business A and Business B to FC under section 351 in exchange for FC stock. Pursuant to § 1.987–2(c)(2)(i) and (ii), as a result of the deemed exchange of the assets and liabilities of Business A and Business B for FC stock in a section 351 transaction, Business A and Business B are each treated as transferring their assets and liabilities to U.S. Corp immediately before U.S. Corp's transfer of such assets and liabilities to FC. The transfer of assets from Business A and Business B to U.S.

Corp causes terminations of those section 987 QBUs under paragraph (b)(2) of this section. The assets and liabilities of Business A and Business B are now owned by FC, but because FC and Business A have the same functional currency, only Business B qualifies as a section 987 QBU to which section 987 applies.

(B) Terminations also would have occurred in 2026 if U.S. Corp had contributed Entity A and Entity B to an existing foreign corporation owned by U.S. Corp or to a newly created foreign corporation owned by U.S. Corp pursuant to a section 351 exchange because the transfer of all of the assets of Business A and Business B would cause terminations of those section 987 QBUs under paragraph (b)(2) of this section.

Example 7. *Sale of a section 987 QBU to a member of a consolidated group*. (i) *Facts*. U.S. Corp, the owner of Business A, sells all of the assets and liabilities of Business A to DS, a domestic corporation, in exchange for cash. U.S. Corp and DS are members of the same consolidated group. The cash received on the sale is recorded on the books of U.S. Corp.

(ii) *Analysis*. Pursuant to § 1.987–2(c)(2)(i) and (ii), Business A is treated as transferring all of its assets and liabilities to U.S. Corp immediately before the sale by U.S. Corp to DS. As a result of this deemed transfer from Business A to U.S. Corp, the Business A section 987 QBU terminates under paragraph (b)(2) of this section.

§ 1.987–9 Recordkeeping requirements.

(a) *In general*. A taxpayer that is an owner of a section 987 QBU shall keep a copy of each election made by the taxpayer in accordance with the rules of § 1.987–1(g)(3) (if not required to be made on a form published by the Commissioner regarding section 987) and such reasonable records as are sufficient to establish the section 987 QBU's taxable income or loss and section 987 gain or loss.

(b) *Supplemental information*. An owner's obligation to maintain records under section 6001 and paragraph (a) of this section is not satisfied unless the following information is maintained in such records with respect to each section 987 QBU:

(1) The amount of the items of income, gain, deduction, or loss attributed to the section 987 QBU in the functional currency of the section 987 QBU.

(2) The amount of assets and liabilities attributed to the section 987 QBU in the functional currency of the section 987 QBU.

(3) The exchange rates used to translate items of income, gain, deduction, or loss of the section 987 QBU into the owner's functional currency and, if a spot rate convention is used, the manner in which such convention is determined.

(4) The exchange rates used to translate the assets and liabilities of the section 987 QBU into the owner's functional currency and, if a spot rate convention is used, the manner in which such convention is determined.

(5) The amount of the items of income, gain, deduction, or loss attributed to the section 987 QBU translated into the functional currency of the owner.

(6) The amount of assets and liabilities attributed to the section 987 QBU translated into the functional currency of the owner.

(7) The amount of assets and liabilities transferred by the owner to the section 987 QBU determined in the functional currency of the owner.

(8) The amount of assets and liabilities transferred by the section 987 QBU to the owner determined in the functional currency of the owner.

(9) The amount of the unrecognized section 987 gain or loss for the taxable year.

(10) The amount of the net accumulated unrecognized section 987 gain or loss at the close of the taxable year.

(11) If a remittance is made, the computations determined under § 1.861–9T(g) for purposes of sourcing and characterizing the remittance under § 1.987–5.

(12) The transition information required to be determined under § 1.987–10(e).

(c) *Retention of records*. The records required by this section, or records that support the information required on a form published by the Commissioner regarding section 987, must be maintained and kept at all times available for inspection by the Internal Revenue Service for so long as the contents thereof may become relevant in the administration of the Internal Revenue Code.

(d) *Information on a dedicated section 987 form*. The requirements of paragraph (b) of this section shall be satisfied if the taxpayer provides the specific information required on a form published by the Commissioner for this purpose.

§ 1.987–10 Transition rules.

(a) *Scope*. These transition rules shall apply to any taxpayer that is an owner of a section 987 QBU pursuant to § 1.987–1(b)(4) on the transition date (as defined in § 1.987–11(c)). Except as provided in paragraph (c) of this section, a taxpayer to which this section applies must transition from the method previously used to comply with section 987 (the “prior section 987 method”) to the method prescribed by these regulations pursuant to the fresh start transition method set forth in paragraph (b) of this section.

(b) *Fresh start transition method*—(1) *In general*. Pursuant to the fresh start transition method, and solely for purposes of this section, all section 987 QBUs of a taxpayer, other than section 987 QBUs subject to paragraph (c) of this section, are deemed to terminate on the day before the transition date. No section 987 gain or loss is determined or recognized as a result of the deemed termination. The owner of a section 987 QBU that is deemed to terminate under this section is treated as having transferred all of the assets and liabilities attributable to such QBU to a new section 987 QBU on the transition date. This deemed transfer of assets and liabilities is taken into account only for purposes

of transitioning to these regulations under section 987 and shall not be taken into account in determining the amounts transferred from the owner to the section 987 QBU during the taxable year for purposes of § 1.987–5(c)(1)(ii).

(2) *Application of § 1.987–4*. For purposes of applying § 1.987–4 with respect to a section 987 QBU described in paragraph (b)(1) of this section for the taxable year beginning on the transition date, the amount of assets and liabilities deemed transferred from the owner to the section 987 QBU on the transition date pursuant to paragraph (b)(1) of this section shall be determined by translating such assets and liabilities (without regard to whether the asset or liability is a marked item or a historic item) at the historic rate as determined under paragraph (b)(3) of this section.

(3) *Determination of historic rate*. For purposes of applying these regulations with respect to a section 987 QBU described in paragraph (b)(1) of this section for taxable years beginning on or after the transition date, the historic rate (as defined in § 1.987–1(c)(3)) for an asset or liability deemed transferred under paragraph (b)(1) of this section from an owner to the section 987 QBU on the transition date shall be the historic rate under § 1.987–1(c)(3) determined by reference to the date the assets were acquired or liabilities entered into or assumed by the section 987 QBU deemed terminated (that is, without regard to the deemed termination or transfer described in paragraph (b)(1) of this section). However, if the owner is not able to determine reliably the historic rate for a particular asset or liability, then the historic rate must be determined based on reasonable assumptions (for example, assumptions about turnover and aging of accounts receivable), consistently applied.

(4) *Example*. The provisions of this paragraph (b) are illustrated by the following example. Exchange rate assumptions used in the example are selected for the purpose of illustrating the principles of this section, and no inference is intended by their use. Additionally, the effect of depreciation is not taken into account for purposes of this example.

Example. (i) U.S. Corp is a domestic corporation with the dollar as its functional currency. U.S. Corp owns Business A, a U.K. branch with the pound as its functional currency. Business A was formed on January 1, year 1. U.S. Corp uses the method prescribed in the 1991 proposed section 987 regulations to determine the section 987 gain or loss of Business A. U.S. Corp contributed £6,000 to Business A on January 1, year 1. On the same day, Business A bought a truck for £4,000 and a computer for £1,000. Business A had profits determined under § 1.987–1(b)(1)(i) through (iii) of the 1991 proposed section 987 regulations of £250 in each of year 1, year 2, and year 3, and the yearly average exchange rate was used in each of those years to translate Business A's profits under the 1991 proposed section 987 regulations. The yearly average exchange rate was £1 = $1.10 in year 1, £1 = $1.20 in year 2, and £1 = $1.30 in year 3. Business A incurred a £50 loss in each of year 4 and year 5. Business A made no remittances to U.S. Corp in any year.

(ii) On January 1, year 5, Business A transitions to the method provided in these regulations pursuant to the fresh start transition method described in paragraph (b) of this section. Pursuant to paragraph (b)(1) of this section, Business A is deemed to terminate on December 31, year 4. However, no section 987 gain or loss is determined or recognized as a result of the deemed termination. Pursuant to paragraph (b)(2) of this section, for purposes of applying § 1.987–4 with respect to Business A for year 5, the amount of assets and liabilities transferred from U.S. Corp to Business A on the transition date shall be determined by translating all of Business A's assets at the historic rates for those assets as determined under § 1.987–1(c)(3) and paragraph (b)(3) of this section. Because U.S. Corp is not able to determine reliably the historic rate for the pound currency it is deemed to transfer to Business A, U.S. Corp determines the historic rate for these pounds based on a last-in, first-out cash flow assumption. Thus, it is assumed that the £50 loss in each of year 4 and year 5 first reduces the £250 earned in year 3. Accordingly, for purposes of determining the amount of assets and liabilities deemed transferred from U.S. Corp to Business A on January 1, year 5, U.S. Corp translates Business A's assets and liabilities as follows:

Assets	***Amount in £***	***Translation Rate***	***Amount in $***
Pounds	£1,000	£1 = $1.10 (yearly average rate-year 1)	$1,100
Pounds	250	£1 = $1.10 (yearly average rate-year 1)	275
Pounds	250	£1 = $1.20 (yearly average rate-year 2)	300
Pounds	150	£1 = $1.30 (yearly average rate-year 3)	195
Truck	4,000	£1 = $1.10 (yearly average rate-year 1)	4,400
Computer	1,000	£1 = $1.10 (yearly average rate-year 1)	*1,100*
Total assets			$7,370
Liabilities			
Total liabilities			$0

(c) *Transition of section 987 QBUs that applied the method set forth in the 2006 proposed section 987 regulations*.—(1) *In general*. If, with respect to a particular section 987 QBU, a taxpayer's prior section 987 method was based on a reasonable application of the method described in the 2006 proposed section 987 regulations (REG–208270–86, 71 FR 52876), then the taxpayer shall apply these regulations under section 987 with respect to such section 987 QBU without regard to paragraph (b) of this section.

(2) *Application of § 1.987–4*. For purposes of applying § 1.987–4 with respect to a section 987 QBU described in paragraph (c)(1) for the taxable year beginning on the transition date, the owner functional currency net value of the section 987 QBU on the last day of the preceding taxable year under § 1.987–4(d)(1)(B) shall be the amount that was determined under § 1.987–4(d)(1)(A) of the 2006 proposed section 987 regulations for the preceding taxable year. Additionally, for purposes of applying § 1.987–4 with respect to a section 987 QBU described in paragraph (c)(1) for all taxable years that end after the transition date, the section 987 QBU's net unrecognized section 987 gain or loss for all prior taxable years under § 1.987–4(c) shall take into account the aggregate of the amounts determined under § 1.987–4(d) of the 2006 proposed section 987 regulations for taxable years for which the taxpayer applied the 2006 proposed section 987 regulations, reduced by the amounts taken into account under § 1.987–5 of the 2006 proposed section 987 regulations upon a remittance for all such prior taxable years.

(3) *Use of prior historic rate*. For purposes of applying these regulations under section 987 with respect to historic items (as defined in § 1.987–1(e)), other than inventory, that are reflected on the balance sheet of the section 987 QBU on the transition date, a taxpayer may use the same historic exchange rates as were used under the taxpayer's application of the 2006 proposed section 987 regulations in place of the historic rates that otherwise would be determined under § 1.987–1(c)(3), provided that, for all taxable years that end after the transition date, the taxpayer does so with respect to all historic items (other than inventory) that are reflected on the balance sheet of the section 987 QBU on the transition date.

(4) *Example*. The provisions of this paragraph (c) are illustrated by the following example. Exchange rate assumptions used in the example are selected for the purpose of illustrating the principles of this section, and no inference is intended by their use. Additionally, the effect of depreciation is not taken into account for purposes of this example.

Example. (i) U.S. Corp is a domestic corporation with the dollar as its functional currency. U.S. Corp owns Business A, a U.K. branch with the pound as its functional currency. Business A was formed on January 1, year 1. U.S. Corp uses a reasonable application of the method described in the 2006 proposed section 987 regulations to determine the section 987 gain or loss of Business A. On January 1, year 5, Business A transitions to the method provided in these regulations pursuant to the method described in this paragraph (c). Business A's

opening balance sheet on January 1, year 5, includes pounds, a truck acquired in year 2, inventory accounted for under the FIFO method, and no liabilities. These assets remain on the balance sheet on December 31, year 5.

(ii) Pursuant to paragraph (c)(3) of this section, U.S. Corp chooses to use the same historic exchange rates as were used under its application of the 2006 proposed regulations in place of the historic rates prescribed under § 1.987–1(c)(3) for purposes of applying these regulations with respect to historic items (other than inventory) held on the transition date.

(iii) The pounds are marked items under § 1.987–1(d). Because the pounds are marked items, for purposes of determining the owner functional currency net value of Business A on the last day of year 5 pursuant to § 1.987–4(e), the pounds are translated into dollars using the spot rate (as defined in § 1.987–1(c)(1)) applicable to the last day of year 5.

(iv) The truck held on Business A's balance sheet on January 1, year 5, is a historic item under § 1.987–1(e). For purposes of determining the owner functional currency net value of Business A on the last day of year 5 pursuant to § 1.987–4(e), the basis of the truck is translated into dollars using the spot rate on the day the truck was acquired in year 2, as determined under § 1.987–1(c)(3) of the 2006 proposed section 987 regulations. If U.S. Corp had not chosen pursuant to paragraph (c)(3) of this section to use the same historic exchange rates as were used under its application of the 2006 proposed regulations, the basis of the truck would have been translated into dollars using the historic rate described in § 1.987–1(c)(3), which is the yearly average exchange rate for year 5.

(v) The inventory held on Business A's balance sheet on January 1, year 5, is a historic item under § 1.987–1(e). For purposes of determining the owner functional currency net value of Business A on the last day of year 5 pursuant to § 1.987–4(e), the FIFO cost basis of the inventory is translated into dollars using the historic rate, which pursuant to § 1.987–1(c)(3)(i)(B) is the yearly average exchange rate for year 5.

(vi) Pursuant to paragraph (c)(3) of this section, for purposes of applying § 1.987–4 with respect to Business A for year 5, the owner functional currency net value of Business A on the last day of year 4 under § 1.987–4(d)(1)(B) is the amount that was determined under § 1.987–4(d)(1)(A) of the 2006 proposed section 987 regulations for year 4. Additionally, Business A's net unrecognized section 987 gain or loss for all prior years under § 1.987–4(c) shall take into account the aggregate of the amounts determined under § 1.987–4(d) of the 2006 proposed section 987 regulations for year 1 through year 4, reduced by the amounts taken into account under § 1.987–5 of the 2006 proposed section 987 regulations upon a remittance for all such prior taxable years.

(d) *Adjustments to avoid double counting*. If a difference between the treatment of any item under these regulations and the treatment of the item under the taxpayer's prior section 987 method would result in income, gain, deduction or loss being taken into account more than once, then the net unrecognized

section 987 gain or loss of the section 987 QBU, as determined under § 1.987–4(b) for the first taxable year for which these regulations apply, shall be adjusted to account for the difference.

(e) *Reporting*—(1) *In general*. Except as otherwise provided in this paragraph (e), the taxpayer must attach a statement titled "Section 987 Transition Information" to its timely filed return for the first taxable year to which these regulations under section 987 apply providing the following information:

(i) A description of each section 987 QBU to which these rules apply, the section 987 QBU's owner, the section 987 QBU's principal place of business, and a description of the prior section 987 method used by the taxpayer to determine section 987 gain or loss with respect to the section 987 QBU.

(ii) Any assumptions used by the taxpayer for determining the exchange rates used to translate the amount of assets and liabilities transferred to the section 987 QBU on the transition date, as provided in paragraph (b)(3) of this section.

(iii) With respect to each section 987 QBU subject to paragraph (c) of this section, a statement regarding whether historic items (as defined in § 1.987–1(c)(3)) are translated pursuant to paragraph (c)(2) of this section at the same historic rates as were used under the taxpayer's application of the 2006 proposed regulations or at the historic rates determined under § 1.987–1(c)(3).

(iv) With respect to each section 987 QBU with respect to which an adjustment is made pursuant to paragraph (d) of this section, a description of the adjustment and the basis for the computation of such adjustments.

(2) *Attachments not required where information is reported on a form*. Paragraph (e) of this section shall not apply to the extent the information described in such paragraph is required to be reported on a form published by the Commissioner.

§ 1.987–11 Effective/applicability date.

(a) *In general*. Except as otherwise provided in this section, §§ 1.987–1 through 1.987–10 shall apply to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016.

(b) *Application of these regulations to taxable years beginning after* December 7, 2016. A taxpayer may apply these regulations under section 987 to taxable years beginning after December 7, 2016, provided the taxpayer consistently applies these regulations to such taxable years with respect to all section 987 QBUs directly or indirectly owned by the taxpayer on the transition date (as defined in paragraph (b)(2) of this section) as well as all section 987 QBUs directly or indirectly owned on the transition date by members that file a consolidated return with the taxpayer or by any controlled foreign corporation, as defined in section 957, in which a member owns more than 50 percent of the voting power or stock value, as determined under section 958(a).

(c) *Transition date*. The transition date is the first day of the first taxable year to which these regulations under section 987 are applicable with respect to a taxpayer under this section.

Par. 6. Section 1.988–0 is amended by adding an entry for § 1.988–1(a)(4).

***§ 1.988–0 Taxation of gain or loss from a section 988 transaction; Table of Contents*.**

* * * * *

***§ 1.988–1 Certain definitions and special rules*.**

(a) * * *

(4) Treatment of assets and liabilities of a section 987 aggregate partnership or DE that are not attributed to an eligible QBU.

* * * * *

Par. 7. Section 1.988–1 is amended by:

1. Adding paragraph (a)(4).

2. Revising paragraph (a)(10)(ii).

3. Adding two sentences to the end of paragraph (i).

The additions and revision read as follows:

***§ 1.988–1 Certain definitions and special rules*.**

(a) * * *

(4) *Treatment of assets and liabilities of a section 987 aggregate partnership or DE that are not attributed to an eligible QBU*—(i) *Scope*. This paragraph (a)(4) applies to assets and liabilities of a section 987 aggregate partnership as defined in § 1.987–1(b)(5), or of an entity disregarded as an entity separate from its owner for Federal income tax purposes (DE), that are not attributable to an eligible QBU as defined in § 1.987–1(b)(3).

(ii) *Section 987 Aggregate Partnerships*. For purposes of applying section 988 and the applicable regulations to transactions involving assets and liabilities described in paragraph (a)(4)(i) of this section that are held by a section 987 aggregate partnership, the owners of the section 987 aggregate partnership (within the meaning of § 1.987–1(b)(4)) shall be treated as owning their share of such assets and liabilities. Section 1.987–7(b) shall apply for purposes of determining an owner's share of such assets or liabilities.

(iii) *Disregarded entities*. For purposes of applying section 988 and the applicable regulations to transactions involving assets and liabilities described in paragraph (a)(4)(i) of this section that are held by a DE, the owner of the DE (within the meaning of § 1.987–1(b)(4)) shall be treated as owning all such assets and liabilities.

(iv) *Example*. The following example illustrates the application of paragraph (a)(4) of this section:

Example. *Liability held through a section 987 aggregate partnership*. (i) *Facts*. P, a foreign partnership, has two equal partners, X and Y. X is a domestic corporation with the dollar as its functional currency. Y is a foreign corporation wholly owned by X that has the yen as its functional currency. P is a section 987 aggregate partnership. On January 1, 2021, P borrowed yen and issued a note to the lender that obligated P to pay interest and repay principal to the lender in yen. Also on January 1, 2021, P used the yen it borrowed from the lender to acquire all of the stock of F, a foreign corporation, from an unrelated person. P also holds an eligible QBU (within the meaning of § 1.987–1(b)(3)) that has the yen as its functional currency. P maintains one set of books and records. The assets and liabilities of the eligible QBU are reflected on the books and records of P as provided under § 1.987–2(b). The F stock held by P, and the yen liability incurred to acquire the F stock, are also recorded on the books and records of P but, pursuant to § 1.987–2(b)(2)(i), are not considered to be reflected on the books and records of the eligible QBU for purposes of section 987.

(ii) *Analysis*. X's portion of the assets and liabilities of the eligible QBU owned by P is a section 987 QBU. Y's portion of the assets and liabilities of the eligible QBU owned by P is not a section 987 QBU because Y and the eligible QBU have the same functional currency. Because the F stock and yen-denominated liability incurred to acquire such stock are not considered reflected on the books and records of the eligible QBU, they are not subject to section 987. In addition, because the F stock and the yen-denominated liability incurred to acquire such stock are held by P (but not attributable to P's eligible QBU), X and Y are treated as owning their respective shares of such stock and liability pursuant to § 1.988–1(a)(4)(ii) for purposes of applying section 988. As a result, P's becoming the obligor on the portion of the yen-denominated note that is treated as an obligation of X is a section 988 transaction pursuant to paragraphs (a)(1)(ii), (a)(2)(ii) and (a)(3) of this section. Similarly, the dispositions of yen to make payments of interest and principal on the liability, to the extent such yen are treated as owned by X under paragraph (a)(4)(ii) of this section, are section 988 transactions under paragraphs (a)(1)(i) and (a)(3) of this section. To the extent the yen are treated as owned by the eligible QBU, see § 1.987–2(c) for the treatment of the payment of yen as a transfer from the eligible QBU to X. P's becoming the obligor on Y's portion of the yen-denominated note, and Y's portion of the yen disposed of in connection with payments on such note, are not section 988 transactions because Y has the yen as its functional currency.

* * * * *

(10) * * *

(ii) *Certain intra-taxpayer transfers of section 988 transactions that result in the recognition of section 988 gain or loss*—(A) *In general*. Exchange gain or loss with respect to nonfunctional currency or any item described in paragraph (a)(2) of this section entered into with another taxpayer shall be realized upon a transfer

(as defined under § 1.987–2(c)) of such currency or item from an owner to a section 987 QBU or from a section 987 QBU to an owner if as a result of such transfer —

(*1*) The currency or item loses its character as nonfunctional currency or as an item described in paragraph (a)(2) of this section; or

(*2*) The source of the exchange gain or loss could be altered absent the application of paragraph (a)(10)(ii)(B) of this section.

(B) *Computation of exchange gain or loss*. Exchange gain or loss described in section (a)(10)(ii)(A) of this section shall be computed in accordance with § 1.988–2 (without regard to § 1.988–2(b)(8)) as if the nonfunctional currency or item described in paragraph (a)(2) of this section had been sold or otherwise transferred at fair market value between unrelated taxpayers. For purposes of the preceding sentence, a taxpayer must use a translation rate that is consistent with the translation conventions of the section 987 QBU to or from which, as the case may be, the item is being transferred. In the case of a gain or loss incurred in a transaction described in this paragraph (a)(10)(ii) that does not have a significant business purpose, the Commissioner may defer such gain or loss.

* * * * *

(i) * * * Generally, the revisions to paragraphs (a)(3), (a)(4), and (a)(10)(ii) of this section shall apply to taxable years beginning one year after the first day of the first taxable year following December 7, 2016. If pursuant to § 1.987–11(b) a taxpayer applies §§ 1.987–1 through 1.987–11 beginning in a taxable year prior to the earliest taxable year described in § 1.987–11(a), then the revisions to paragraphs (a)(3), (a)(4), and (a)(10)(ii) of this section shall apply to taxable years of the taxpayer beginning on or after the first day of such prior taxable year.

Par. 8. Section 1.988–4 is amended by revising paragraph (b)(2) to read as follows:

§ 1.988–4 Source of gain or loss realized on a section 988 transfer

* * * * *

(b) * * *

(2) *Proper reflection on the books of the taxpayer or qualified business unit*—(i) *In general*. For purposes of paragraph (b)(1) of this section, the principles of § 1.987–2(b) shall apply in determining whether an asset, liability, or item of income or expense is reflected on the books and records of a qualified business unit.

(ii) *Effective/applicability date*. Generally, paragraph (b)(2)(i) of this section shall apply to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. If pursuant to § 1.987–11(b) a taxpayer applies §§ 1.987–1 through 1.987–11 beginning in a taxable year prior

to the earliest taxable year described in § 1.987–11(a), then paragraph (b)(2)(i) of this section shall apply to taxable years of the taxpayer beginning on or after the first day of such prior taxable year.

* * * * *

Par. 9. Section 1.989(a)–1 is amended by revising paragraph (b)(2)(i) and adding paragraphs (b)(4) and (d)(3) and (4) to read as follows:

***§ 1.989(a)–1 Definition of a qualified business unit*.**

(b) * * *

(2) * * *

(i) *Persons*—(A) *Corporations*. A corporation is a QBU.

(B) *Individuals*. An individual is not a QBU.

(C) *Partnerships*. A partnership, other than a section 987 aggregate partnership as defined in § 1.987–1(b)(5), is a QBU.

(D) *Trusts and estates*. A trust or estate is a QBU of a beneficiary.

* * * * *

(4) *Effective/applicability date*. Generally, the revisions to paragraph (b)(2)(i) of this section shall apply to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. If pursuant to § 1.987–11(b) a taxpayer applies §§ 1.987–1 through 1.987–11 beginning in a taxable year prior to the earliest taxable year described in § 1.987–11(a), then the effective date of the revisions to paragraph (b)(2)(i) of this section with respect to the taxpayer shall apply to taxable years of the taxpayer beginning on or after the first day of such prior taxable year.

* * * * *

(d) * * *

(3) *Proper reflection on the books of the taxpayer or qualified business unit*. The principles of § 1.987–2(b) shall apply in determining whether an asset, liability, or item of income or expense is reflected on the books of a qualified business unit (and therefore is attributable to such unit).

(4) *Effective/applicability date*. Generally, the revisions to paragraph (d)(3) of this section shall apply to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. If pursuant to § 1.987–11(b) a taxpayer applies §§ 1.987–1 through 1.987–11 beginning in a taxable year prior to the earliest taxable year described in § 1.987–11(a), then the revisions to paragraph (b)(2)(i) of this section shall apply with respect to taxable years of the taxpayer beginning on or after the first day of such prior taxable year.

* * * * *

§ 1.989(c)–1 [Removed]

Par. 10. Section 1.989(c)–1 is removed.

PART 602 — OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 11. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 12. In § 602.101, paragraph (b) is amended by adding an entry in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB Control No.
* * * * *	
1.987-1	1545-2265
1.987-3	1545-2265
1.987-9	1545-2265
1.987-10	1545-2265
* * * * *	

John Dalrymple, *Deputy Commissioner for Services and Enforcement.*

Approved November 14, 2016

Mark J. Mazur, *Assistant Secretary of the Treasury (Tax Policy).*

Note

(Filed by the Office of the Federal Register on December 7, 2016, 8:45 a.m., and published in the issue of the Federal Register for December 8, 2016, 81 F.R. 88806)

[1] The legislative history of section 987 is discussed extensively in the preamble to the 2006 proposed regulations. *See* 71 FR 52876.

[2] ASC 830 codifies Financial Accounting Standard No. 52.

[3] The functional currency of a foreign entity is defined in ASC 830 as the currency of the primary economic environment in which the entity operates.

[4] ASC 830–30–45–3.

[5] ASC 830–10–55–10–11,830–30–45–3.

[6] ASC 830–30–45–3.

[7] ASC 830–30–45–12.

[8] ASC 830–30–40–1.

[9] ASC 830–230–45–1.

[10] ASC 830–20–35–1.

T.D. 9795

Recognition and Deferral of Section 987 Gain or Loss

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

AGENCY:

Internal Revenue Service (IRS), Treasury.

ACTION:

Final and temporary regulations.

SUMMARY:

This document contains temporary regulations under section 987 of the Internal Revenue Code (Code) relating to the recognition and deferral of foreign currency gain or loss under section 987 with respect to a qualified business unit (QBU) in connection with certain QBU terminations and certain other transactions involving partnerships. This document also contains temporary regulations under section 987 providing: an annual deemed termination election for a section 987 QBU; an elective method, available to taxpayers that make the annual deemed termination election, for translating all items of income or loss with respect to a section 987 QBU at the yearly average exchange rate; rules regarding the treatment of section 988 transactions of a section 987 QBU; rules regarding QBUs with the U.S. dollar as their functional currency; rules regarding combinations and separations of section 987 QBUs; rules regarding the translation of income used to pay creditable foreign income taxes; and rules regarding the allocation of assets and liabilities of certain partnerships for purposes of section 987. Finally, this document contains temporary regulations under section 988 requiring the deferral of certain

section 988 loss that arises with respect to related-party loans. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the Proposed Rules section in this issue of the **Bulletin.** In addition, in the Rules and Regulations section of this issue of the **Bulletin,** final regulations are being issued under section 987 to provide general guidance under section 987 regarding the determination of the taxable income or loss of a taxpayer with respect to a QBU.

DATES:

Effective date. These regulations are effective on December 7, 2016.

Applicability date. For dates of applicability, see §§ 1.987–1T(h), 1.987–2T(e), 1.987–3T(f), 1.987–4T(h), 1.987–6T(d), 1.987–7T(d), 1.987–8T(g), 1.987–12T(j), 1.988–1T(j), and 1.988–2T(j).

FOR FURTHER INFORMATION CONTACT:

Steven D. Jensen at (202) 317-6938 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These temporary regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545-2265. Responses to this collection of information are mandatory.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

For further information concerning this collection of information, the accuracy of the estimated burden and suggestions for reducing this burden, and where to submit comments on the collection of information, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in the Proposed Rules section of this issue of the **Bulletin.**

Books and records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains temporary regulations under section 987 of the Code relating to the recognition and deferral of foreign currency gain or loss under section 987 with respect to a QBU in connection with certain QBU terminations and certain other transactions involving partnerships. This document also contains temporary regulations under section 987 providing (i) an annual deemed termination election for a section 987 QBU; (ii) an elective method, available to taxpayers that make the annual deemed termination election, for translating all items of income or loss with respect to a section 987 QBU at the yearly average exchange rate; (iii) rules regarding the treatment of section 988 transactions of a section 987 QBU; (iv) rules regarding QBUs with the U.S. dollar as their functional currency; (v) rules regarding combinations and separations of section 987 QBUs; (vi) rules regarding the translation of income used to pay creditable foreign income taxes; and (vii) rules regarding the allocation of assets and liabilities of certain partnerships for purposes of section 987. Finally, this document contains temporary regulations under section 988 requiring the deferral of certain section 988 loss that arises with respect to related-party loans.

Section 987 generally provides that, when a taxpayer owns one or more QBUs with a functional currency other than the U.S. dollar and such functional currency is different than that of the taxpayer, the taxable income or loss of the taxpayer with respect to each such QBU is determined by computing the taxable income or loss of each QBU separately in its functional currency and translating such income or loss at the appropriate exchange rate. Section 987 further requires the taxpayer to make "proper adjustments" (as prescribed by the Secretary of the Treasury (the Secretary)) for transfers of property between QBUs having different functional currencies, including by treating post-1986 remittances from each such QBU as made on a pro rata basis out of post-1986 accumulated earnings, by treating section 987 gain or loss as ordinary income or loss, and by sourcing such gain or loss by reference to the source of the income giving rise to post-1986 accumulated earnings.

Section 989(c) directs the Secretary to "prescribe such regulations as may be necessary or appropriate to carry out the purposes of [subpart J], including regulations . . . limiting the recognition of foreign currency loss on certain remittances from qualified business units . . . [and] providing for the appropriate treatment of related party transactions (including transactions between qualified business units of the same taxpayer) . . . ."

On September 6, 2006, the Treasury Department and the IRS issued proposed regulations under section 987 (REG–208270–86, 71 FR 52876) (the 2006 proposed regulations). The Treasury Department and the IRS received many written comments in response to the 2006 proposed regulations and, after consideration of those comments, are issuing final regulations (**TD 9794**) under section 987 (the final regulations) that are being published contemporaneously with these temporary regulations. These temporary regulations also reflect the consideration of comments received on the 2006 proposed regulations, as well as other considerations described in this preamble.

Explanation of Provisions

1. *Deferral of Section 987 Gain or Loss on Certain Terminations and Other Transactions Involving Partnerships*

A. *Background*

Under the final regulations, the owner of a section 987 QBU that terminates includes in income all of the net unrecognized section 987 gain or loss with respect to the section 987 QBU in the year it terminates. See §§ 1.987–5(c)(3) and 1.987–8(e). Section 1.987–8(b) and (c) describe the circumstances in which a section 987 QBU terminates, which include the transfer (or deemed transfer) of substantially all of the assets of the section 987 QBU and when the section 987 QBU's owner ceases to exist (except in connection with certain liquidations or reorganizations described in section 381(a)). Under these rules, a termination can result solely from a transfer of a section 987 QBU between related parties or, when a QBU is owned by an entity that is disregarded as an entity separate from its owner for Federal tax purposes (DE), from the deemed transfer that occurs when an election is made to treat the DE as a corporation for Federal tax purposes, notwithstanding that the QBU's assets continue to be used in the same trade or business.

The preamble to the 2006 proposed regulations requested comments regarding whether inbound liquidations under section 332 and inbound asset reorganizations under section 368(a) should result in terminations of section 987 QBUs. The preamble also requested comments on the interaction of the rules of § 1.1502–13 regarding intercompany transactions with the 2006 proposed regulations, including whether section 987 gain or loss resulting from the transfer of assets and liabilities of a section 987 QBU between members of the same consolidated group in a section 351 transaction should be deferred under § 1.1502–13. Many comments recommended that such a section 351 exchange should not trigger the recognition of section 987 gain or loss.

Because a termination can result in the deemed remittance of all the assets of a section 987 QBU in circumstances in which the assets continue to be used by a related person in the conduct of the same trade or business that formerly was conducted by the section 987 QBU, terminations can facilitate the selective recognition of section 987 losses. Section 989(c)(2) provides the Treasury Department and the IRS with authority to "limit[] the recognition of foreign currency loss on certain remittances from qualified business units." The Treasury Department and the IRS have determined that terminations of section 987 QBUs generally should not be permitted to achieve the selective recognition of losses when the assets and liabilities of the section 987 QBU are transferred to a related person and remain subject to section 987 in the hands of the transferee, as in the case, for example, of a section 351 transfer of a

section 987 QBU within a consolidated group. Similar policy considerations arise when the transfer of a partnership interest to a related person results in deemed transfers that cause the recognition of section 987 loss with respect to a section 987 QBU owned through the partnership, notwithstanding that the trade or business of the section 987 QBU continues without interruption and remains subject to section 987. In order to address these policy concerns, as described in greater detail in Part 1.C of this Explanation of Provisions, the temporary regulations defer section 987 losses resulting from certain termination events and partnership transactions in which the assets and liabilities of the section 987 QBU remain within a single controlled group (defined as all persons with the relationships to each other described in sections 267(b) or 707(b)) and remain subject to section 987.

The Treasury Department and the IRS also acknowledge, however, that part of the rationale for deferring section 987 losses — that is, the continuity of ownership of the section 987 QBU within a single controlled group — applies equally to section 987 gains that otherwise would be triggered when taxpayers transfer a section 987 QBU within a single controlled group. Thus, consistent with the recommendations of comments on the 2006 proposed regulations, the temporary regulations generally apply to defer the recognition of section 987 gains as well as losses when the transferee is subject to section 987 with respect to the assets of the section 987 QBU. The Treasury Department and the IRS have determined, however, that gain should not be deferred to the extent the assets of a section 987 QBU are transferred by a U.S. person to a related foreign person. Since recognition of the deferred gain generally would occur only as a result of remittances to the foreign owner, the IRS could face administrative difficulty in attempting to ensure that such deferred gain is appropriately recognized and not indefinitely deferred. Treating gains differently than losses in the context of transfers to related foreign persons generally is consistent with the policies underlying sections 267 and 367. In particular, this rule is consistent with the policy of recognizing foreign currency gains and not losses with respect to property transferred outbound in a nonrecognition transaction. See section 367(a)(3)(B)(iii).

In addition, the Treasury Department and the IRS have determined that selective recognition of losses should not be permitted in the context of certain outbound transfers even when the assets do not remain subject to section 987 in the hands of the transferee (because, for example, the transferee has the same functional currency as the QBU). Accordingly, consistent with the principles of sections 267 and 367(a), the temporary regulations also provide special rules to prevent the selective recognition of section 987 losses in certain other transactions involving outbound transfers.

B. *Scope of application of § 1.987–12T*

Section 1.987–12T provides for the deferral of certain net unrecognized section 987 gain or loss that otherwise would be recognized in connection with specified events under § 1.987–5, which governs the recognition of section 987

gain or loss by the owner of a section 987 QBU to which the final regulations apply. In addition, because the policy concerns that motivate § 1.987–12T exist regardless of whether section 987 gain or loss is computed pursuant to the final regulations or some other reasonable method, § 1.987–12T applies to any foreign currency gain or loss realized under section 987(3), including foreign currency gain or loss realized under section 987 with respect to a QBU to which the final regulations generally are not applicable. In order to achieve this, the temporary regulations specify that references in § 1.987–12T to section 987 gain or loss refer to any foreign currency gain or loss realized under section 987(3) and that references to a section 987 QBU refer to any eligible QBU (as defined in § 1.987–1(b)(3)(i), but without regard to § 1.987–1(b)(3)(ii)) that is subject to section 987. Additionally, the temporary regulations specify that references in § 1.987–12T to the recognition of section 987 gain or loss under § 1.987–5 encompass any determination and recognition of gain or loss under section 987(3) that would occur but for § 1.987–12T. Accordingly, the temporary regulations require an owner of a QBU that is not subject to § 1.987–5 to adapt the rules set forth in § 1.987–12T to recognize section 987 gains or losses consistent with the principles of § 1.987–12T.

The policy concerns regarding selective realization of section 987 losses do not apply, however, with respect to a section 987 QBU that has made the annual deemed termination election described in Part 2 of this Explanation of Provisions, because all section 987 gain and loss is recognized annually under that election. Accordingly, § 1.987–12T is not applicable to section 987 gain or loss of a section 987 QBU with respect to which the annual deemed termination election is in effect.

Finally, in order to avoid any compliance burden associated with applying § 1.987–12T in circumstances involving relatively small amounts of section 987 gain or loss, § 1.987–12T includes a de minimis rule. That rule provides that § 1.987–12T does not apply to a section 987 QBU if the net unrecognized section 987 gain or loss of the section 987 QBU that, as a result of § 1.987–12T, would not be recognized under § 1.987–5 does not exceed $5 million.

Section 1.987–12T defers the recognition of section 987 gains and losses in connection with two types of specified events, which are referred to as “deferral events” and “outbound loss events.” Parts 1.C and 1.D of this Explanation of Provisions describe the rules governing deferral events and outbound loss events, respectively.

C. *Deferral events*

As described in greater detail below, the temporary regulations provide that, notwithstanding § 1.987–5, the owner of a section 987 QBU with respect to which a deferral event occurs (a deferral QBU) must defer section 987 gain or loss that otherwise would be taken into account under § 1.987–5 in connection with the deferral event to the extent determined under § 1.987–12T(b)(3) and (c). Such deferred gain or loss is taken into account based on subsequent events in accordance with § 1.987–12T(c).

i. Deferral Events

The temporary regulations provide that a deferral event with respect to a section 987 QBU means any transaction or series of transactions that satisfy two conditions. Under the first condition, the transaction or series of transactions must be described in one of two categories. The first category, which is set forth in § 1.987–12T(b)(2)(ii)(A), is any termination of a section 987 QBU other than (i) a termination described in § 1.987–8(b)(3) (that is, a termination that results from the owner of the section 987 QBU ceasing to be a controlled foreign corporation (as defined in section 957(a)) (CFC) after certain related-party transactions); (ii) a termination described in § 1.987–8(c) (that is, a termination that results from a liquidation or asset reorganization described in section 381(a) involving an inbound or outbound transfer, a transfer by a CFC to a related non-CFC foreign corporation, or a transfer to a transferee that has the same functional currency as the section 987 QBU);[11] or (iii) a termination described solely in § 1.987–8(b)(1) (that is, a termination that results solely from the cessation of the trade or business of the section 987 QBU). Thus, the first category generally involves terminations that occur as a result of a transfer of substantially all the assets of a section 987 QBU other than a transfer as part of a transaction described in section 381(a) in which the owner ceases to exist. (A termination that results from an outbound section 381(a) transaction, however, may be an outbound loss event.)

The second category, which is described in § 1.987–12T(b)(ii)(B), encompasses certain partnership transactions that result in a net deemed transfer from a section 987 QBU to its owner as a result of which section 987 gain or loss otherwise would be recognized under § 1.987–5. The second category refers to two types of transactions involving partnerships.

First, the second category includes a disposition of part of an interest in a DE or partnership. Under § 1.987–2(c)(5), a transfer of part of an interest in a DE or section 987 aggregate partnership results in deemed transfers to the owner of a section 987 QBU held through that DE or partnership that may result in a remittance, but that generally do not cause a termination. For an illustration of the application of § 1.987–12T to a deferral event resulting from the conversion of a disregarded entity into a section 987 aggregate partnership, see § 1.987–12T(h), *Example 4*.

The second type of transaction included in the second category is a contribution of assets by a related person to a partnership or DE through which a section 987 QBU is held, provided that the contributed assets are not included on the books and records of an eligible QBU and the contribution causes a net transfer from a section 987 QBU owned through the partnership or DE. The rules of § 1.987–2 must be applied to determine whether the contribution would cause a net transfer from any section 987 QBUs held through a partnership. For example, if two partners (Partner A and Partner B) each own a 50% interest in an existing section 987 aggregate partnership with a single section 987 QBU, and Partner A contributes cash that is included on the books of the section 987

QBU after the contribution and Partner B contributes an equal amount of non-portfolio stock, the contributions would not cause either Partner A nor Partner B to have a net transfer from the section 987 QBU under § 1.987–2 and there would be no section 987 gain or loss to defer. As a result of the broad scope of application for § 1.987–12T specified in § 1.987–12T(a)(2), the second category includes transactions involving partnerships that are not section 987 aggregate partnerships even though QBUs that are held through such partnerships generally are not subject to the final regulations. Accordingly, § 1.987–12T applies to a disposition of a partnership interest or a contribution to a partnership if it otherwise would result in recognition of gain or loss under a taxpayer's reasonable method of applying section 987.

The second condition described in § 1.987–12T(b)(2) is that, immediately after the transaction or series of transactions, assets of the section 987 QBU are reflected on the books and records of a successor QBU. For this purpose, a successor QBU with respect to a section 987 QBU (original QBU) generally means a section 987 QBU on whose books and records assets of the original QBU are reflected immediately after the deferral event, provided that, immediately after the deferral event, the section 987 QBU is owned by a member of the controlled group that includes the person that owned the original QBU immediately before the deferral event. This relatedness requirement would not be met, for example, if the person that owned the original QBU ceased to exist in connection with the deferral event.

However, if the owner of the original QBU is a U.S. person, then a successor QBU does not include a section 987 QBU owned by a foreign person, except in the case of a deferral event that is solely described in the second category of transactions involving partnership and DE interests. This limitation on the definition of a successor QBU in the context of outbound transfers serves two purposes. First, consistent with the general policy of recognizing foreign currency gains upon an outbound transfer, the limitation ensures that section 987 gain is recognized to the extent section 987 QBU assets are transferred outbound in connection with a termination. Second, the limitation coordinates the deferral event rules with the outbound loss event rules described in Part 1.D of this Explanation of Provisions, which contain different rules for the recognition of section 987 loss attributable to assets of a section 987 QBU that are transferred outbound in connection with a termination of the section 987 QBU.

ii. Recognition of Section 987 Gain or Loss Under § 1.987–5 in the Taxable Year of a Deferral Event

The temporary regulations provide that, in the taxable year of a deferral event, the owner of the deferral QBU generally recognizes section 987 gain or loss as determined under § 1.987–5, except that, solely for purposes of applying § 1.987–5, all assets and liabilities of the deferral QBU that, immediately after the deferral event, are properly reflected on the balance sheet of a successor QBU are treated as not having been transferred and therefore as remaining on the

balance sheet of the deferral QBU, notwithstanding the deferral event. The effect of these rules is that, in the taxable year of a deferral event, only assets and liabilities of the deferral QBU that are not reflected on the books and records of a successor QBU immediately after the deferral event are taken into account in determining the amount of a remittance from the deferral QBU. Section 987 gain or loss that, as a result of these rules, is not recognized under § 1.987–5 in the taxable year of the deferral event is referred to as deferred section 987 gain or loss. As discussed in Part 1.D of this Explanation of Provisions, if the deferral event also constitutes an outbound loss event, the amount of loss recognized by the owner may be further limited under the rules applicable to outbound loss events.

iii. Recognition of Deferred Section 987 Gain or Loss in the Taxable Year of a Deferral Event and in Subsequent Taxable Years

The temporary regulations provide rules for determining when a deferral QBU owner recognizes deferred section 987 gain or loss. For this purpose, a deferral QBU owner means, with respect to a deferral QBU, the owner of the deferral QBU immediately before the deferral event with respect to the deferral QBU or the owner's qualified successor. The temporary regulations define a qualified successor with respect to a corporation (transferor corporation) as another corporation (acquiring corporation) that acquires the assets of the transferor corporation in a transaction described in section 381(a), but only if (A) the acquiring corporation is a domestic corporation and the transferor corporation was a domestic corporation, or (B) the acquiring corporation is a CFC and the transferor corporation was a CFC. A qualified successor of a corporation includes a qualified successor of a qualified successor of the corporation.

As described in the remainder of this Part 1.C.iii, the temporary regulations provide that deferred section 987 gain or loss is recognized upon subsequent remittances from a successor QBU, or upon a deemed remittance that occurs when a successor QBU ceases to be owned by a member of the deferral QBU owner's controlled group, subject to an exception that applies when a successor QBU terminates in an outbound transfer. In general, these rules depend on the continued existence of a deferral QBU owner (which includes a qualified successor) and a successor QBU and preserve the location of the deferred section 987 gain or loss as gain or loss of the deferral QBU owner.

a. Subsequent remittances

A deferral QBU owner generally recognizes deferred section 987 gain or loss in the taxable year of a remittance from a successor QBU to the owner of the successor QBU (successor QBU owner). The amount of deferred section 987 gain or loss that a deferral QBU owner recognizes upon a remittance is the outstanding deferred section 987 gain or loss (that is, the deferred section 987 gain or loss not previously recognized) multiplied by the remittance proportion of the successor QBU owner with respect to the successor QBU for the taxable year as determined under § 1.987–5(b) and, to the extent relevant, § 1.987–12T. For an illustration of this rule, see § 1.987–12T(h), *Example 5*.

In certain cases, there may be multiple successor QBUs with respect to a single deferral QBU. For instance, there may be multiple successor QBUs if the owner of a section 987 aggregate partnership interest transfers part of its interest or if a successor QBU separates into two or more separated QBUs under § 1.987–2T(c)(9)(ii). To ensure that a deferral QBU owner recognizes the appropriate amount of deferred section 987 gain or loss in connection with a remittance in such cases, the temporary regulations provide that multiple successor QBUs of the same deferral QBU are treated as a single successor QBU for purposes of determining the amount of deferred section 987 gain or loss that is recognized.

For example, if the owner (Corp A) of a section 987 aggregate partnership interest transfers part of its interest to another member of Corp A's consolidated group (Corp B), the transfer would give rise to a deferral event with respect to the section 987 QBU (QBU A) that Corp A indirectly owns through the partnership. QBU A would be considered a deferral QBU, and Corp A would be considered a deferral QBU owner. In addition, QBU A would be considered a successor QBU with respect to itself, and the section 987 QBU (QBU B) that Corp B owns indirectly through the partnership interest it acquired also would be considered a successor QBU with respect to QBU A. In determining the amount of deferred section 987 gain or loss recognized upon subsequent remittances from successor QBUs, the two successor QBUs are treated as a single successor QBU, such that their remittance proportion is determined under § 1.987–5 on a combined basis, taking into account the assets and remittances of both successor QBUs.

b. Deemed remittance when a successor QBU ceases to be owned by a member of the deferral QBU owner's controlled group

Solely for purposes of determining a deferral QBU owner's recognition of any outstanding deferred section 987 gain or loss, a successor QBU owner is treated as having a remittance proportion of 1 in a taxable year in which its successor QBU ceases to be owned by a member of a controlled group that includes the deferral QBU owner, including as a result of the deferral QBU owner ceasing to exist without having a qualified successor. Accordingly, a deferral QBU owner would recognize all outstanding deferred section 987 gain or loss upon a successor QBU ceasing to be owned by a member of the deferral QBU owner's controlled group if there is only one successor QBU, but would recognize only a proportional amount if there are multiple successor QBUs, one or more of which remain in the deferral QBU owner's controlled group.

c. Recognition of deferred section 987 loss in certain outbound successor QBU terminations

Notwithstanding that deferred section 987 gain or loss generally is recognized upon remittances from a successor QBU, § 1.987–12T(c)(3) provides that, if assets of a successor QBU are transferred (or deemed transferred) in an exchange that would constitute an outbound loss event if the successor QBU had a net accumulated section 987 loss at the time of the exchange, the deferral QBU owner recognizes any outstanding deferred section 987 loss on a similar

basis as it would if it originally had transferred the deferral QBU in an outbound loss event. Any outstanding deferred section 987 loss with respect to the deferral QBU that, as a result of this rule, is not recognized is recognized by the deferral QBU owner in the first taxable year in which the deferral QBU owner (including any qualified successor) and the acquirer of the assets of the successor QBU (or any qualified successor) cease to be members of the same controlled group. Section 1.987–12T(c)(4) ensures that the policy concerns that motivate the treatment of outbound loss events under the temporary regulations apply in comparable circumstances involving successor QBUs. See Part 1.D of this Explanation of Provisions for an explanation of outbound loss events.

d. Special rules regarding successor QBUs

The temporary regulations include three special rules regarding successor QBUs that are relevant to the recognition of deferred section 987 gain or loss. First, if a section 987 QBU is a successor QBU with respect to a deferral QBU that is a successor QBU with respect to another deferral QBU, the first-mentioned section 987 QBU is considered a successor QBU with respect to the second-mentioned deferral QBU. For example, if QBU A is a successor QBU with respect to QBU B, and QBU B is a successor QBU with respect to QBU C, then QBU A is a successor QBU with respect to QBU C.

Second, if a successor QBU with respect to a deferral QBU separates into two or more separated QBUs (as defined in § 1.987–2T(c)(9)(iii)), each separated QBU is considered a successor QBU with respect to the deferral QBU.

Third, if a successor QBU with respect to a deferral QBU combines with another section 987 QBU of the same owner, resulting in a combined QBU (as defined in § 1.987–2T(c)(9)(i)), the combined QBU is considered a successor QBU with respect to the deferral QBU.

iv. Source and Character of Deferred Section 987 Gain and Loss

The temporary regulations provide that the source and character of deferred section 987 gain or loss is determined under § 1.987–6 as if such gain or loss had been recognized with respect to the deferral QBU under § 1.987–5 on the date of the deferral event that gave rise to the deferred section 987 gain or loss. Thus, the source and character of deferred section 987 gain or loss is determined under § 1.987–6 without regard to the timing rules of § 1.987–12T.

D. *Outbound loss events*

Section 1.987–12T(d) of the temporary regulations contains rules that defer section 987 loss to the extent assets of a section 987 QBU are transferred outbound to a related foreign person in connection with an “outbound loss event.” Specifically, the temporary regulations provide that, notwithstanding § 1.987–5, the owner of a section 987 QBU with respect to which an outbound loss event occurs (outbound loss QBU) includes in taxable income in the year of the outbound loss event section 987 loss with respect to that section 987 QBU only

to the extent provided in § 1.987–12T(d)(3). Sections 1.987–12T(d)(4) and (5) provide rules for the subsequent recognition of losses that are deferred under § 1.987–12T(d) that differ from the remittance-based rules that generally apply following deferral events.

Like the definition of deferral event, an outbound loss event includes two categories of transactions with respect to a section 987 QBU with net unrecognized section 987 loss. First, an outbound loss event includes any termination of the section 987 QBU in connection with a transfer of assets of the section 987 QBU by a U.S. person to a foreign person that was a member of the same controlled group as the U.S. transferor immediately before the transaction or, if the transferee did not exist immediately before the transaction, immediately after the transaction (related foreign person). The second category of outbound loss events includes any transfer by a U.S. person of part of an interest in a section 987 aggregate partnership or DE through which the U.S. person owns the section 987 QBU to a related foreign person that has the same functional currency as the section 987 QBU. The second category also includes a contribution of assets by such a related foreign person to the partnership or DE if the contribution has the effect of reducing the U.S. person's interest in the section 987 QBU (and therefore causes a deemed transfer of assets and liabilities to the U.S. person from the section 987 QBU) and the contributed assets are not included on the books and records of an eligible QBU of the partnership or DE. The second category would be implicated, for example, if a U.S. person transferred part of the interest in a DE through which it owned a section 987 QBU to a foreign corporation that had the same functional currency as the section 987 QBU in an outbound section 351 transaction.

Under these rules, the owner of the outbound loss QBU recognizes section 987 loss in the taxable year of the outbound loss event as determined under § 1.987–5 and the deferral event rules of § 1.987–12T(b) and (c), except that, solely for purposes of applying § 1.987–5, certain assets and liabilities of the outbound loss QBU are treated as not having been transferred and therefore as remaining on the balance sheet of the section 987 QBU, notwithstanding the outbound loss event. In the first category of outbound loss event (involving outbound asset transfers resulting in terminations), assets and liabilities that, immediately after the outbound loss event, are properly reflected on the books and records of the related foreign person or a section 987 QBU of the related foreign person are treated as not having been transferred. In the second category of outbound loss event (involving certain partnership and DE transactions), assets and liabilities that, immediately after the outbound loss event, are reflected on the books and records of the eligible QBU from which the assets and liabilities of the outbound loss QBU are allocated, and not on the books and records of a section 987 QBU, are treated as not having been transferred. The difference between the amount that otherwise would have been recognized and the amount actually recognized under this rule is referred to as outbound section 987 loss.

Although an outbound loss event in the second category also would constitute a deferral event, the rules governing deferral events only defer section 987 loss of a deferral QBU to the extent assets and liabilities are reflected on the books and records of a successor QBU immediately after the deferral event. Assets and liabilities of a deferral QBU that are reflected on the books and records of an eligible QBU of a partnership and allocated to a partner that has the same functional currency as the eligible QBU, as would occur in an outbound loss event, are not reflected on the books and records of a successor QBU and so would not cause section 987 loss to be deferred under the deferral event rules. Thus, there is no overlap in terms of the effect of the outbound loss event rules and the deferral event rules.

If an outbound loss event results from the transfer of assets of the outbound loss QBU in a nonrecognition transaction, the basis of the stock that is received in the transaction is increased by an amount equal to the outbound section 987 loss. In effect, this rule converts a section 987 loss into an unrealized stock loss, which may be recognized upon a recognition event with respect to the stock. This treatment is similar to the treatment under section 367(a) of foreign currency losses with respect to foreign-currency denominated property that is transferred outbound in a nonrecognition event to a foreign corporation that has as its functional currency the currency in which the property is denominated. Outbound section 987 loss attributable to an outbound loss event that does not occur in connection with a nonrecognition transaction is recognized by the owner of the outbound loss QBU in the first taxable year in which the owner (or any qualified successor) and the related foreign person that participated in the outbound loss event (or any qualified successor) cease to be members of the same controlled group. In many circumstances this treatment will provide similar results as converting section 987 loss into stock basis as in the case of outbound loss events that result from a nonrecognition transaction.

The temporary regulations provide that, if loss is recognized on the sale or exchange of stock within two years of an outbound loss event that gave rise to an adjustment to the basis of the stock, then, to the extent of the outbound section 987 loss, the source and character of the loss recognized on the sale or exchange will be determined under § 1.987–6 as if such loss were section 987 loss recognized pursuant to § 1.987–5 without regard to § 1.987–12T on the date of the outbound loss event.

E. *Anti-abuse rule*

The temporary regulations provide an anti-abuse rule to address transactions structured to avoid the deferral rules in § 1.987–12T. This rule provides that no section 987 loss is recognized under § 1.987–5 in connection with a transaction or series of transactions that are undertaken with a principal purpose of avoiding the purposes of § 1.987–12T. This rule would apply, for example, if, with a principal purpose of recognizing a deferred section 987 loss, a taxpayer engaged in a transaction that caused a deferral QBU owner to cease to exist

without a qualified successor or caused a successor QBU to cease to exist, such that deferred section 987 loss otherwise would be recognized under § 1.987–12T(c).

F. *Coordination with fresh start transition method*

The temporary regulations require adjustments to coordinate the application of § 1.987–12T with the fresh start transition method described in § 1.987–10(b) for transitioning to the final regulations. If a deferral QBU owner is required under § 1.987–10(a) to apply the fresh start transition method with respect to the deferral QBU on the transition date, or if a deferral QBU owner would have been so required if it had owned the deferral QBU on the transition date, the outstanding deferred section 987 gain or loss of the deferral QBU owner with respect to the deferral QBU must be adjusted on the transition date to equal the amount of outstanding deferred section 987 gain or loss that the deferral QBU owner would have had with respect to the deferral QBU on the transition date if, immediately before the deferral event, the deferral QBU had transitioned to the final regulations pursuant to the fresh start transition method. Additionally, if the owner of an outbound loss QBU is required under § 1.987–10(a) to apply the fresh start transition method with respect to the outbound loss QBU on the transition date, or if the owner would have been so required if it had owned the outbound loss QBU on the transition date, the basis of any stock that was subject to a basis adjustment under § 1.987–12T as a result of the outbound loss event must be adjusted to equal the basis that such stock would have had on the transition date if, immediately prior to the outbound loss event, the outbound loss QBU had transitioned to the final regulations pursuant to the fresh start transition method. Outbound section 987 loss that is not reflected in stock basis but that will be recognized when the owner and the related foreign person that participated in the outbound loss event cease to be members of the same controlled group must be adjusted in a similar manner. These adjustments to coordinate the application of § 1.987–12T with the fresh start transition method must be made even if the deferral QBU owner or the owner of the outbound loss QBU continues to own the deferral QBU or the outbound loss QBU on the transition date, as in the case of a deferral event or outbound loss event resulting from a transfer of part of an interest in a section 987 aggregate partnership that does not result in the termination of the deferral QBU or outbound loss QBU.

G. *Effective date*

The temporary regulations under § 1.987–12T generally apply to any deferral event or outbound loss event that occurs on or after *January 6, 2017*. However, if the deferral event or outbound loss event is undertaken with a principal purpose of recognizing section 987 loss, the 30 day delayed effective date does not apply and § 1.987–12T is effective immediately on December 7, 2016.

2. *Annual Deemed Termination Election*

A comment on the 2006 proposed regulations recommended that taxpayers be permitted to make a one-time election under § 1.987–5 to deem a section 987 QBU as having terminated at the end of each year, thereby requiring the owner to recognize all section 987 gains or losses with respect to the QBU on an annual basis. The comment suggested that such an election would allow taxpayers to reduce the complexity and administrative cost of complying with section 987 because taxpayers would not be required to track transactions between an owner and its section 987 QBU or unrecognized section 987 gains and losses carried over from previous years.

The Treasury Department and the IRS have determined that an annual deemed termination election would not obviate the need to track transactions between an owner and its section 987 QBU, since the net transfer would remain relevant to the annual calculation of section 987 gain or loss. Nonetheless, the Treasury Department and the IRS agree that an annual deemed termination election could enhance administrability of the final regulations by reducing the recordkeeping requirements necessary to apply the final regulations. Additionally, when an annual deemed termination election is in effect, taxpayers could not strategically time remittances in order to selectively recognize section 987 losses but not section 987 gains. Eliminating this planning opportunity would obviate the need for the deferral provisions of § 1.987–12T. Furthermore, as discussed in Part 3 of this Explanation of Provisions, an annual deemed termination election would address a policy concern with permitting the hybrid approach to section 987 suggested by comments on the 2006 proposed regulations.

Based on the foregoing considerations, § 1.987–8T(d) provides an election for a taxpayer to deem its section 987 QBUs to terminate on the last day of each taxable year for which the election is in effect. Because the considerations supporting an annual deemed termination election generally are relevant regardless of whether a taxpayer is subject to the final regulations, the election under § 1.987–8T(d) is available to any taxpayer without regard to the applicability of the final regulations to that taxpayer or any of its section 987 QBUs. A section 987 QBU to which this election applies is treated as having made a remittance of all of its gross assets to its owner immediately before the section 987 QBU terminates on the last day of each taxable year, resulting in the recognition of any net unrecognized section 987 gain or loss of the section 987 QBU. See §§ 1.987–5(c)(3) and 1.987–8(e). The owner is then treated as having transferred all of the assets and liabilities of the terminated section 987 QBU to a new section 987 QBU on the first day of the following taxable year.

As noted in Part 1 of this Explanation of Provisions, the temporary regulations provide that the deferral provisions of § 1.987–12T do not apply with respect to section 987 QBUs for which the annual deemed termination election is in effect. Consequently, a taxpayer that finds the annual deemed termination election preferable to § 1.987–12T based on ease of compliance or other reasons may make the annual deemed termination election. Moreover, as discussed in Part 3 of this Explanation of Provisions, a taxpayer that makes the annual deemed

termination election with respect to a section 987 QBU may reduce the compliance burden associated with computing taxable income or loss under the final regulations by electing to translate taxable income or loss of the section 987 QBU into the owner's functional currency at the yearly average exchange rate without any adjustments.

The Treasury Department and the IRS have determined that special consistency and effective date rules are needed for the annual deemed termination election to prevent taxpayers from using the election to selectively recognize section 987 losses without recognizing section 987 gains. Unless the annual deemed termination election is required to be made with respect to all section QBUs owned by related persons at the time of the election, taxpayers could choose to make the election only with respect to section 987 QBUs that have net unrecognized section 987 losses at the time of the election. Accordingly, § 1.987–1T(g)(2)(i)(B)(*1*) provides that the annual deemed termination election generally applies to all section 987 QBUs owned by an electing taxpayer, as well as to all section 987 QBUs owned by any person that has a relationship to the taxpayer described in section 267(b) or section 707(b) (substituting "and the profits interest" for "or the profits interest" in section 707(b)(1)(A) and substituting "and profits interests" for "or profits interests" in section 707(b)(1)(B)) on the last day of the first taxable year for which the election applies to the taxpayer (a related person).

A taxpayer that is subject to the final regulations and that must transition to the final regulations under the fresh start transition method of § 1.987–10(b) (fresh start taxpayer) may make the annual deemed termination election only if the first taxable year for which the election would apply is either (i) the first taxable year beginning on or after the transition date (as defined in § 1.987–11(c)) with respect to the taxpayer or (ii) a subsequent taxable year in which the "taxpayer's controlled group aggregate section 987 loss" (if any) does not exceed $5 million. For this purpose, a "taxpayer's controlled group aggregate section 987 loss" means the aggregate net amount of section 987 gain or loss that would be recognized pursuant to the election under § 1.987–8T(d) by the taxpayer and all related persons in the first taxable year of each person for which the election would apply.

Taxpayers that used a method based on a reasonable application of the 2006 proposed regulations prior to the transition date, and which therefore are not subject to the fresh start transition method pursuant to § 1.987–10(c), and taxpayers for which the final regulations are not applicable, must follow the election rules for fresh start taxpayers if any related party is a fresh start taxpayer. If no related party is a fresh start taxpayer, the annual deemed termination election may be made only if the first taxable year for which the election would apply is either (i) the first taxable year beginning on or after December 7, 2016, in which the election is relevant in determining section 987 taxable income or loss or section 987 gain or loss or (ii) a subsequent taxable year in which the "taxpayer's controlled group aggregate section 987 loss" (if any) does not exceed $5 million.

If a taxpayer makes the annual deemed termination election, the election will apply to the first taxable year of a related person that ends with or within a taxable year of the taxpayer to which the taxpayer's election applies. Once made, the annual deemed termination election may not be revoked.

As provided in § 1.987–1T(g)(2)(i)(B)(*2*), the special consistency and effective date rules in § 1.987–1T(g)(2)(i)(B)(*1*) do not apply and a taxpayer may make a separate election under § 1.987–8T(d) with respect to any section 987 QBU owned by the taxpayer if the first taxable year for which the election would apply to the taxpayer with respect to the section 987 QBU is a taxable year in which the deemed termination results in the recognition of section 987 gain with respect to the section 987 QBU or the deemed termination results in the recognition of $1 million or less of section 987 loss with respect to the section 987 QBU.

3. *Election to Translate All Items at the Yearly Average Exchange Rate*

As discussed in the preamble to the final regulations, comments on the 2006 proposed regulations recommended a hybrid approach that would combine the methodology of the regulations proposed under section 987 in 1991 (INTL–965–86, 56 FR 48457) for computing a section 987 QBU's net income with the methodology of the 2006 proposed regulations for computing section 987 gain or loss. Under the proposed hybrid approach, section 987 gain or loss generally would be determined under the method of the 2006 proposed regulations, but taxable income or loss would be translated into the owner's functional currency at the yearly average exchange rate without any adjustments.

Although a hybrid approach would simplify the calculation of section 987 taxable income or loss, the preamble to the final regulations observes that the hybrid approach gives rise to offsetting effects in section 987 taxable income or loss and in the foreign exchange exposure pool (FEEP) that raise concerns similar to those addressed by Congress in enacting section 1092. In particular, under the hybrid approach, exchange rate effects with respect to historic assets would be reflected in section 987 taxable income or loss to the extent of any cost recovery deductions with respect to those assets, but equal and offsetting amounts would be reflected in the FEEP and would be recognized only upon remittances. Thus, offsetting effects arising from a single asset would be taken into account at different times. The Treasury Department and the IRS have determined that it would be inappropriate for regulations under section 987 to permit distortions to section 987 taxable income or loss that have the effect of causing potentially large offsetting amounts of loss or gain to be reflected in the FEEP with respect to the same asset, since the loss or gain in the FEEP would be recognized only upon voluntary remittances from the QBU.

Nonetheless, the Treasury Department and the IRS acknowledge the concerns expressed in comments regarding the complexity of the 2006 proposed regulations that underlie the recommendation to adopt the hybrid approach. Concerns about offsetting amounts recognized at different times under the hybrid approach would not arise for taxpayers that make the annual deemed

termination election set forth in § 1.987–8T(d). A taxpayer that recognizes all section 987 gain or loss with respect to its section 987 QBUs annually would take into account in recognized section 987 gain or loss the exchange rate effects with respect to historic assets that are reflected in the FEEP in the same taxable year in which the offsetting effects are taken into account in section 987 taxable income or loss. Although the hybrid approach could result in differences in character of exchange gain or loss relative to the final regulations even for taxpayers that make the annual deemed termination election, the Treasury Department and the IRS have determined that the administrative convenience of allowing taxpayers to translate a section 987 QBU's taxable income at the yearly average exchange rate outweighs that consideration.

Accordingly, the temporary regulations provide that a taxpayer that is otherwise generally subject to the final regulations may elect to apply the hybrid approach with respect to a section 987 QBU that is subject to the annual deemed termination election. In particular, § 1.987–3T(d) provides that, notwithstanding the rules of § 1.987–3(c) for translating items determined under § 1.987–3(b) in a section 987 QBU's functional currency into the owner's functional currency, a taxpayer may elect to translate all items of income, gain, deduction, and loss of a section 987 QBU with respect to which the annual deemed termination election described in § 1.987–8T(d) is in effect into the owner's functional currency, if necessary, at the yearly average exchange rate for the taxable year. An owner of multiple section 987 QBUs may make the election described in § 1.987–3T(d) with respect to all of its section 987 QBUs or only certain designated section 987 QBUs.

4. *Section 988 Transactions of a Section 987 QBU*

A. *Background regarding the treatment of section 988 transactions under the proposed regulations*

The 2006 proposed regulations reflected a two-pronged approach to the application of section 988 to transactions of a section 987 QBU, with different consequences generally depending on whether a transaction is denominated in (or determined by reference to) the owner's functional currency or a currency that is a nonfunctional currency with respect to both the owner and the section 987 QBU (third currency). As a general rule, § 1.987–3(e)(1) of the 2006 proposed regulations provided that section 988 applies to section 988 transactions attributable to a section 987 QBU and that the timing of any gain or loss is determined under the applicable provisions of the Code, but the 2006 proposed regulations did not clearly specify whether section 988 gain or loss would be determined with respect to the functional currency of the section 987 QBU or the owner's functional currency. Assets and liabilities giving rise to section 988 transactions were defined under proposed § 1.987–1(d) and (e) as historic items. Under § 1.987–3(e)(2) of the 2006 proposed regulations, transactions of a section 987 QBU described in section 988(c)(1)(B)(i) (relating to the acquisition of, or becoming an obligor under, a debt instrument), section 988(c)(1)(B)(ii)

(relating to accrual of items of expense or gross income or receipts) or section 988(c)(1)(C) (relating to the disposition of nonfunctional currency) that are denominated in (or determined by reference to) the owner's functional currency, however, were not treated as section 988 transactions of the section 987 QBU, and no gain or loss was recognized under section 988 with respect to such transactions. Assets and liabilities giving rise to such transactions were required to be reflected on the balance sheet of the section 987 QBU in the owner's functional currency under § 1.987–2(d)(2) of the 2006 proposed regulations.

Additionally, § 1.987–3(d) of the 2006 proposed regulations provided that an item of income, gain, deduction, or loss of a section 987 QBU denominated in a currency other than the functional currency of the owner is translated at the spot rate on date the item is appropriately taken into account. Under § 1.987–3(c) of the 2006 proposed regulations, an item of income, gain, deduction, or loss of a section 987 QBU denominated in the owner's functional currency is not translated and is taken into account by the section 987 QBU in the owner's functional currency.

One comment indicated that the 2006 proposed regulations were unclear regarding the interaction of the rules for the treatment of section 988 transactions denominated in a third currency with the treatment of assets that give rise to section 988 transactions as historic assets. Upon the disposition of a historic asset, the 2006 proposed regulations required translation of the basis of the historic asset at the historic rate and the amount realized with respect to the asset at the yearly average exchange rate for the taxable year of the disposition or, if properly elected, the appropriate spot rate. Yet, § 1.987–3(f), *Example 10* of the 2006 proposed regulations illustrated the determination of section 988 gain or loss on a third-currency section 988 transaction in, and by reference to, the section 987 QBU's functional currency and translation of that amount into the owner's functional currency at the yearly average exchange rate. Under the approach of the example, historic asset basis is effectively translated at the yearly average exchange rate rather than the appropriate historic rate.

B. *General rules for section 988 transactions in the temporary regulations*

In light of the comment regarding the uncertain application of section 988 to transactions of a section 987 QBU under the 2006 proposed regulations and further consideration of the appropriate rules, the temporary regulations clarify and elaborate upon the application of section 988 to transactions attributable to a section 987 QBU. In this regard, the Treasury Department and the IRS have determined that computing section 988 gain or loss by reference to the functional currency of the section 987 QBU, rather than the owner's functional currency, and translating that amount at the yearly average exchange rate would be inconsistent with the treatment of items that give rise to section 988

transactions as historic items. Such items were treated as historic items under the 2006 proposed regulations because they do not economically expose the owner to fluctuations in the section 987 QBU's functional currency.

Taking these considerations into account, the Treasury Department and the IRS have determined that it is appropriate to continue to treat assets and liabilities giving rise to section 988 transactions of a section 987 QBU as historic items under §§ 1.987–1(d) and (e) of the final regulations. Thus, for example, a note denominated in a nonfunctional currency that gives rise to a section 988 transaction when acquired is a historic asset. However, the temporary regulations generally provide that section 988 gain or loss arising from section 988 transactions of a section 987 QBU is determined by reference to the owner's functional currency, rather than the functional currency of the section 987 QBU. See § 1.987–3T(b)(4)(i). Accordingly, in determining section 988 gain or loss with respect to a section 988 transaction of a section 987 QBU, the amounts required under section 988 to be translated on the applicable booking date or payment date with respect to the section 988 transaction are translated from the currency in which the amounts are denominated (or by reference to which they are determined) into the owner's functional currency at the rate required under section 988 and the section 988 regulations, which provide for translation at the appropriate spot rate.

When a section 987 QBU recognizes gain or loss on the disposition of a historic asset that gives rise to a section 988 transaction, some or all of the total gain or loss that is realized on the disposition may be section 988 gain or loss that, under section 988, is ordinary income that is sourced by reference to the residence of the section 987 QBU. For example, on the disposition of a nonfunctional currency note, the total gain or loss realized may be comprised of section 988 gain or loss that reflects exchange rate changes and other gain or loss that reflects other factors, such as changes in prevailing interest rates or in the creditworthiness of the note issuer. The total gain or loss on the disposition of a historic asset that gives rise to a section 988 transaction is determined under the general rules of section 987 by reference to the functional currency of the section 987 QBU. Section 988 gain or loss on the note is determined under §§ 1.988–2(b)(5) and (8) and 1.987–3T(b)(4)(i) by comparing the section 987 QBU's acquisition price for the note in nonfunctional currency translated into the owner's functional currency at the spot rates on the date of acquisition and the date of disposition, respectively. See § 1.987–3T(e), *Example 11*. To provide for consistent translation rates for determining both the total gain or loss on such a historic asset and the portion of the total gain or loss that is section 988 gain or loss, § 1.987–3T(c)(2)(ii) specifies that the spot rate also must be used to translate the amount received with respect to a historic asset if the acquisition of the historic asset gave rise to a section 988 transaction. Additionally, consistent with the regulations under § 1.988–1(d) regarding the use of spot rate conventions for section 988 transactions, § 1.987–1T(c)(1)(ii)(B) specifies that the election in § 1.987–1(c)(1)(ii)(A) to use a spot rate convention generally does not apply for purposes of determining section 987 taxable income or loss with

respect to a historic item (as defined in § 1.987–1(e)) if acquiring, accruing, or entering into such item gave rise to a section 988 transaction or a specified owner functional currency transaction (discussed in this Part B).

Because assets and liabilities that give rise to section 988 transactions generally are historic items that have a spot rate as the historic rate under § 1.987–1T(c)(3)(i)(E), such assets and liabilities are translated at historic rates and do not give rise to section 987 gain or loss. Thus, when the general rules for section 988 transactions of a section 987 QBU apply, the owner will take into account under subpart J foreign currency exposure with respect to a section 988 transaction of a section 987 QBU only to the extent of the owner's economic exposure to fluctuations of its functional currency relative to the currency in which the section 988 transaction is denominated.

Additionally, consistent with the 2006 proposed regulations, the temporary regulations confirm that certain transactions that are denominated in (or determined by reference to) the owner's functional currency are not subject to section 988. Specifically, § 1.987–3T(b)(4)(ii) provides that specified owner functional currency transactions, which are defined as transactions described in section 988(c)(1)(B)(i) or (ii) or section 988(c)(1)(C) (including the acquisition of nonfunctional currency described in § 1.988–1(a)(1)) that are denominated in (or determined by reference to) the owner's functional currency, other than certain transactions described in § 1.987–3T(b)(4)(iii)(A) that are subject to a mark-to-market regime (discussed in Part 4.C of this Explanation of Provisions), are not treated as section 988 transactions. Although the temporary regulations do not follow the 2006 proposed regulations in specifying that assets and liabilities that give rise to specified owner functional currency transactions must be reflected on the balance sheet of the section 987 QBU in the owner's functional currency, the temporary regulations treat items that give rise to specified owner functional currency transactions as historic items that generally have a spot rate as the historic rate under § 1.987–1T(c)(3)(i)(E) and provide under § 1.987–3T(b)(2)(ii) that the basis and amount realized of a historic asset that gives rise to a specified owner functional currency transactions are not translated if denominated in the owner's functional currency. Together, these rules have the same effect as the treatment of specified owner functional currency transactions under the 2006 proposed regulations.

C. *Special rules to allow greater conformity with the financial accounting treatment for certain section 988 transactions*

As discussed in the preamble to the final regulations, under the financial accounting standard described in Accounting Standards Codification, Foreign Currency Matters, section 830 (ASC 830), gains and losses from changes in exchange rates with respect to transactions that are denominated in a currency other than the entity's functional currency are referred to as "transaction" gains and losses. The category of foreign currency transactions that give rise to transaction gains and losses for financial accounting purposes overlaps

considerably with the definition of a section 988 transaction for tax purposes, such that transaction gains and losses under financial accounting rules are conceptually similar to section 988 gains and losses. The financial accounting rules require the inclusion of transaction gains and losses in net income for the period in which the exchange rate changes occur. See ASC 830-20-35-1. Moreover, transaction gain or loss is always determined by reference to the functional currency of the entity that entered into the transaction. Thus, the financial accounting rules differ from the general tax rules applicable to section 988 transactions entered into by a section 987 QBU in two respects. First, the financial accounting rules require transaction gain or loss to be determined on a mark-to-market basis, whereas gain or loss from a section 988 transaction generally is not recognized until there is a realization event under general tax principles and the applicable provisions of the Code. Second, the financial accounting rules require transaction gain or loss to be determined by reference to the entity's functional currency, even when it differs from the reporting currency used in the consolidated financial statements and the transaction is denominated in the reporting currency.

As noted in the preamble to the final regulations, comments on the 2006 proposed regulations expressed a preference for greater consistency of the section 987 regulations with financial accounting rules. Taking these comments into account, the Treasury Department and the IRS have determined that providing treatment similar to the financial accounting treatment for certain section 988 transactions of section 987 QBUs will enhance administrability of the section 987 regulations with respect to such transactions and is consistent with the policies of sections 987 and 988.

Accordingly, as discussed in Part 1.C.i of this Explanation of Provisions, the temporary regulations permit a taxpayer to elect to determine section 987 gain or loss with respect to qualified short-term section 988 transactions (described in Part 1.C.i of this Explanation of Provisions) of a section 987 QBU under a foreign currency mark-to-market method of accounting. In addition, as discussed in Part 4.C.ii of this Explanation of Provisions, the temporary regulations provide that section 988 gain or loss with respect to qualified short-term section 988 transactions that are accounted for under a mark-to-market method of accounting for Federal tax purposes (including the elective method described in Part 1.C.i of this Explanation of Provisions) is determined in, and by reference to, the functional currency of the section 987 QBU rather than the functional currency of its owner.

i. Election to Apply a Foreign Currency Mark-to-Market Method of Accounting for Certain Section 988 Transactions

The Treasury Department and the IRS have determined that allowing a taxpayer to mark to market foreign currency gain or loss with respect to qualified short-term section 988 transactions of a section 987 QBU will enhance administrability by aligning the timing for recognizing gain or loss with respect to such transactions with the financial accounting rules. Accordingly, a taxpayer

may elect, on a QBU-by-QBU basis, under § 1.987–3T(b)(4)(iii)(C) to apply the foreign currency mark-to-market method of accounting to qualified short-term section 988 transactions. Under this election, the timing of section 988 gain or loss is determined for applicable transactions under the principles of section 1256(a)(1). Thus, when the election applies, section 988 gain or loss with respect to a qualified short-term section 988 transaction is recognized on an annual basis, but other gain or loss with respect to any property underlying the transaction (e.g., gain or loss on a debt instrument due to interest rate fluctuations) is determined under the otherwise applicable recognition provisions.

A qualified short-term section 988 transaction is defined in § 1.987–3T(b)(4)(iii)(B) as a section 988 transaction, including a transaction denominated in the owner's functional currency, that both (1) occurs in the ordinary course of the section 987 QBU's business and (2) has an original term of one year or less on the day it is entered into by the section 987 QBU. The holding of currency that is nonfunctional currency (within the meaning of section 988(c)(1)(C)(ii)) to the section 987 QBU in the ordinary course of a section 987 QBU's trade or business also is treated as a qualified short-term section 988 transaction.

ii. Special Rule Requiring Gain or Loss from Certain Section 988 Transactions that are Subject to a Mark-to-Market Method of Accounting to be Determined by Reference to the Functional Currency of the Section 987 QBU

The temporary regulations include a special rule for determining section 988 gain or loss with respect to qualified short-term section 988 transactions (as described in Part 4.C.i of this Explanation of Provisions) of a section 987 QBU that are accounted for under a mark-to-market method of accounting. Specifically, § 1.987–3T(b)(4)(iii)(A) provides that section 988 gain or loss with respect to qualified short-term section 988 transactions of a section 987 QBU, and certain related hedges, that are accounted for under a mark-to-market method of accounting under section 475, section 1256, or § 1.987–3T(b)(4)(iii)(C) (discussed in Part 4.C.i of this Explanation of Provisions) is determined in, and by reference to, the functional currency of the section 987 QBU rather than the owner's functional currency. Items that give rise to qualified short-term section 988 transactions for which section 988 gain or loss is determined under § 1.987–3T(b)(4)(iii)(A) by reference to the section 987 QBU's functional currency are treated as marked items under § 1.987–1T(d)(3), with the result that gain or loss attributable to such items is translated at the yearly average exchange rate and that such items give rise to net unrecognized section 987 gain or loss.

Under the rules for qualified short-term section 988 transactions accounted for under a mark-to-market method of accounting, a section 987 QBU owner will take into account the full amount of its economic foreign currency exposure arising from such transactions, but the effects of such exposure generally will be bifurcated into a component reflected in section 987 taxable income or loss and a component reflected in the FEEP pool and recognized upon a remittance.

These components could offset each other if the currency in which the section 988 transaction is denominated and the owner's functional currency moved in opposite directions relative to the section 987 QBU's functional currency. Restricting this treatment to qualified short-term section 988 transactions accounted for under a mark-to-market method of accounting limits the potential for abusive planning. In particular, the restriction to transactions accounted for under a mark-to-market method of accounting prevents selective realization of section 988 losses that would be taken into account in section 987 taxable income or loss in situations in which an offsetting gain is reflected in the FEEP. Additionally, short-term, ordinary-course section 988 transactions are less likely than other section 988 transactions to give rise to substantial offsetting effects in section 987 taxable income or loss and in the FEEP.

5. *Application of Section 987 to QBUs with the U.S. Dollar as a Functional Currency*

Consistent with the opening clause of section 987, which indicates that section 987 applies to the determination of the taxable income of any taxpayer "having 1 or more qualified business units with a functional currency other than the dollar," § 1.987–1T(b)(6)(i) sets forth a general rule that section 987 and the regulations thereunder do not apply with respect to an eligible QBU (determined without regard to the scope limitations of § 1.987–1(b)(3)(ii)) that has the U.S. dollar as its functional currency and that would be subject to section 987 if it had a functional currency other than the U.S. dollar (dollar QBU).

The Treasury Department and the IRS have determined, however, that it is appropriate for a CFC that is the owner of a dollar QBU to recognize foreign currency gain or loss with respect to transactions of the dollar QBU that would be section 988 transactions if entered into directly by the owner. Accordingly, pursuant to the authority granted in section 985(a), § 1.987–1T(b)(6)(ii)(A) provides that the CFC owner of a dollar QBU will be subject to section 988 with respect to any item that is properly reflected on the books and records of the dollar QBU and that would give rise to a section 988 transaction if such item were acquired, accrued, or entered into directly by the owner of the dollar QBU. For purposes of applying section 988 to such items, § 1.987–1T(b)(6)(ii)(A) provides that such items are treated as properly reflected on the books and records of the dollar QBU's owner. Thus, except as provided in the special rule described later in this Part 5 of this Explanation of Provisions for computing income that is effectively connected with the conduct of a trade or business within the United States (ECI), a CFC would determine section 988 gain or loss from transactions of a dollar QBU by reference to the CFC's functional currency. For example, for purposes of determining its earnings and profits, a CFC that has a euro functional currency and that is the owner of a dollar QBU with a U.S. dollar-denominated liability would apply section 988 with respect to that U.S. dollar-denominated liability, measuring section 988 gain or loss on the section 988 transaction arising from the liability by reference to the euro.

As a result of treating such items as properly reflected on the books and records of the CFC, instead of those of the dollar QBU, the CFC's section 988 gain or loss with respect to such items generally would be treated as foreign source income because section 988(a)(3) generally provides that the source of section 988 gain or loss is determined by reference to the residence of the taxpayer or QBU on whose books the asset, liability, or other item giving rise to the section 988 transaction is properly reflected. Section 1.988–4 then would apply to determine whether the section 988 gain or loss would be treated as ECI. Because a QBU with ECI must have the U.S. dollar as its functional currency (§ 1.985–1(b)(1)(v)), section 988 gain or loss measured by reference to the owner CFC's functional currency would not be ECI. However, the temporary regulations provide a special rule for certain section 988 transactions of a dollar QBU (including section 988 transactions denominated in the owner's functional currency) that arise from the conduct of a United States trade or business.

The special rule applies to a CFC owner of a dollar QBU that would have a section 988 transaction that would give rise to section 988 gain or loss that would be treated as ECI under § 1.988–4(c) if the item that would give rise to the section 988 transaction were treated as properly reflected on the books and records of the dollar QBU. Under § 1.987–1T(b)(6)(ii)(B), solely for purposes of determining the amount of section 988 gain or loss of the CFC that is ECI, any section 988 gain or loss that would be determined under section 988 as a result of the acquisition or accrual of any item and treated as ECI if the item were treated as properly reflected on the books and records of the dollar QBU is determined by treating such item as properly reflected on the books and records of the dollar QBU and, consequently, is determined by reference to the U.S. dollar.

The application of § 1.987–1T(b)(6)(ii) to a section 988 transaction that is denominated in a third currency (that is, neither the CFC's functional currency nor the U.S. dollar) could result in the same section 988 transaction generating ECI (determined by reference to the U.S. dollar) and generating subpart F income (determined by reference to the CFC owner's functional currency), subject to any limitation imposed by section 952(b). Under section 952(b), if the amount determined under § 1.987–1T(b)(6)(ii)(A) by reference to the owner's functional currency and the amount of ECI determined under § 1.987–1T(b)(6)(ii)(B) were both gains, only the excess, if any, of the gain determined by reference to the owner's functional currency over the ECI gain would be taken into account in determining subpart F income. If the amount determined under § 1.987–1T(b)(6)(ii)(A) by reference to the owner's functional currency and the amount of ECI determined under § 1.987–1T(b)(6)(ii)(B) were both losses, the loss determined by reference to the owner's functional currency would be taken into account in determining subpart F income only to the extent it exceeds the ECI loss.

The Treasury Department and the IRS recognize the potential administrative burden associated with applying the foregoing rules to a dollar QBU, which may give rise to a large number of section 988 transactions. Accordingly, § 1.987–

1T(b)(6)(iii) provides an election for a CFC that directly or indirectly owns a dollar QBU to apply section 987 and the regulations thereunder in lieu of applying section 988 pursuant to § 1.987–1T(b)(6)(ii). The Treasury Department and the IRS have determined that, when this election applies, the source of foreign currency gain or loss that is determined under section 987 pursuant to the election should be consistent with the source that would have been determined under section 988 in the absence of the election. Accordingly, consistent with the source rule in section 988(a)(3), § 1.987–6T(b)(4) provides that the source of section 987 gain or loss determined with respect to a dollar QBU for which the owner has elected to apply section 987 is determined by reference to the residence of the CFC owner. Thus, such section 987 gain or loss will have a foreign source.

As is the case for dollar QBUs of CFCs that do not make the election under § 1.987–1T(b)(6)(iii) to apply section 987, CFCs that make the election and that have a dollar QBU that engages in a U.S. trade or business must apply a special rule to determine the amount of ECI that arises from transactions that would give rise to section 988 gain or loss if determined by reference to the dollar QBU's U.S. dollar functional currency. This special rule for determining the amount of ECI applies only to dollar QBUs that generate ECI because, under § 1.985–1(b)(1)(v), a QBU that produces income or loss that is, or is treated as, ECI must use the dollar as its functional currency. The special rule is needed for dollar QBUs that elect to be treated as section 987 QBUs because, under the general rules of § 1.987–3T(b)(4)(i) and (ii), which apply to all section 987 QBUs other than with respect to certain short-term transactions described in § 1.987–3T(b)(4)(iii)(B) that are accounted for under a mark-to-market method of accounting, section 988 gain or loss of a section 987 QBU with respect to transactions denominated in a third currency is determined in, and by reference to, the functional currency of the owner of the section 987 QBU, and section 988 gain or loss generally is not determined with respect to specified owner functional currency transactions described in Part 4.B of this Explanation of Provisions. Thus, in order to determine the appropriate amount of ECI from transactions of a dollar QBU for which an election to apply section 987 is in effect, § 1.987–1T(b)(6)(iii)(B) provides that, solely for purposes of determining the amount of section 988 gain or loss that is ECI, any section 988 gain or loss that would be determined under section 988 as a result of the acquisition or accrual of any item and treated as ECI under § 1.988–4(c) if the item were treated as properly reflected on the books and records of the dollar QBU is determined by treating the item as properly reflected on the books and records of the dollar QBU. Consequently, solely for that purpose, such section 988 gain or loss is determined by reference to the U.S. dollar. For purposes of determining the amount of section 988 gain or loss for other purposes, including to determine the earnings and profits of the CFC, the rules in § 1.987–3T(b)(4)(i) and (ii) continue to apply. As is the case for a CFC that has not made the election to apply section 987 in lieu of section 988, a transaction to which the special rule applies could generate both ECI and subpart F income.

6. *Combinations and Separations of QBUs*

A. *Combinations and separations do not give rise to transfers*

Under § 1.987–2(c), an asset or liability is treated as transferred to a section 987 QBU from its owner if, as a result of a disregarded transaction, the asset or liability is reflected on the books and records of the section 987 QBU. Similarly, an asset or liability is treated as transferred from a section 987 QBU to its owner if, as a result of a disregarded transaction, the asset or liability is no longer reflected on the books and records of the section 987 QBU. For this purpose, a disregarded transaction generally means a transaction that is not regarded for Federal income tax purposes. Absent a special rule, the combination of multiple section 987 QBUs that have the same owner, or the separation of a section 987 QBU into two or more section 987 QBUs that have the same owner, would give rise to a transfer between an owner and one or more section 987 QBUs under the final regulations.

Consistent with the policy of deferring section 987 gain or loss under § 1.987–12T when assets of a section 987 QBU are reflected on the books and records of another section 987 QBU in the same controlled group as a result of certain transactions that result in deemed transfers, the Treasury Department and the IRS have determined that it would not be appropriate for combinations or separations of section 987 QBUs of the same owner to give rise to transfers to or from the section 987 QBUs. Accordingly, under the temporary regulations, section 987 gain or loss generally is not recognized when two or more section 987 QBUs (combining QBUs) with the same owner combine into a single section 987 QBU (combined QBU) or when a section 987 QBU (separating QBU) separates into multiple section 987 QBUs (each, a separated QBU).

Specifically, notwithstanding the general rule of the final regulations, § 1.987–2T(c)(9)(i) provides that the combination of two or more combining QBUs that have the same owner into a combined QBU does not give rise to a transfer of any combining QBU's assets or liabilities to the owner. In addition, § 1.987–2T(c)(9)(i) provides that transactions between the combining QBUs occurring in the taxable year of the combination, which otherwise would give rise to transfers, do not result in a transfer of the combining QBUs' assets or liabilities to the owner under § 1.987–2(c). For this purpose, a combination occurs when the assets and liabilities that are properly reflected on the books and records of two or more combining QBUs begin to be properly reflected on the books and records of a combined QBU and the separate existence of the combining QBUs ceases. A combination may result from any transaction or series of transactions in which combining QBUs become a combined QBU.

Similarly, § 1.987–2T(c)(9)(iii) provides that the separation of a separating QBU into two or more separated QBUs that have the same owner after the separation does not give rise to a transfer of any of the separating QBU's assets or liabilities to the owner. For this purpose, a separation occurs when assets and liabilities that are properly reflected on the books and records of a separating QBU begin to be properly reflected on the books and records of two or more

separated QBUs. A separation may result from any transaction or series of transactions in which the separating QBU becomes two or more separated QBUs.

B. *Determination of net unrecognized section 987 gain or loss of combined QBUs and separated QBUs*

The temporary regulations generally require combining the aggregate net unrecognized section 987 gain or loss of combining QBUs for purposes of determining net unrecognized section 987 gain or loss of the combined QBU and require apportioning the net unrecognized section 987 gain or loss of a separating QBU among separated QBUs in proportion to their respective shares of the aggregate adjusted basis of the separating QBU's gross assets. Specifically, § 1.987–4T(f)(1) provides that the net unrecognized section 987 gain or loss of a combined QBU for a taxable year is determined by taking into account the net accumulated unrecognized section 987 gain or loss of each combining QBU for all prior taxable years for which the final regulations apply and treating the combining QBUs as having combined immediately prior to the beginning of the taxable year of combination. Additionally, § 1.987–4T(f)(2) provides that the net unrecognized section 987 gain or loss of a separated QBU for a taxable year is determined by taking into account the separated QBU's share of the net accumulated unrecognized section 987 gain or loss of the separating QBU for all prior taxable years for which the final regulations apply and treating the separating QBU as having separated immediately prior to the beginning of the taxable year of separation. No transactions are deemed to occur between the separating QBUs in the taxable year of separation prior to the completion of the separation. A separated QBU's share of the separating QBU's net accumulated unrecognized section 987 gain or loss for all prior taxable years is determined by apportioning the separating QBU's net accumulated unrecognized section 987 gain or loss for all prior taxable years to each separated QBU in proportion to the aggregate adjusted basis of the gross assets properly reflected on the books and records of each separated QBU immediately after the separation.

The temporary regulations also clarify at § 1.987–2T(c)(9)(ii) that, if a combining section 987 QBU has a different functional currency than the combined QBU, the combining section 987 QBU will be deemed to have automatically changed its functional currency to the functional currency of the combined section 987 QBU immediately prior to the combination. A combining section 987 QBU that is deemed to change its functional currency under this paragraph must make the adjustments described in § 1.985–5.

7. *Translation of Foreign Taxes Claimed as a Foreign Tax Credit and Related Income*

Under the general rule of § 1.987–3(c)(1), the owner of a section 987 QBU uses the yearly average exchange rate (as defined in § 1.987–1(c)(2)) to translate an item of income, gain, deduction, or loss of a section 987 QBU into the owner's

functional currency. Alternatively, the owner of a section 987 QBU may elect to use the spot rate (as defined in § 1.987–1(c)(1)) for the day each item is taken into account.

Under section 986(a)(1)(A), for purposes of determining the amount of its foreign tax credit, a taxpayer that takes foreign income taxes into account when accrued generally translates the amount of any foreign income taxes (and any adjustments thereto) into dollars using the average exchange rate for the taxable year to which such taxes relate. However, sections 986(a)(1)(B) and (C) contain exceptions to this general rule, including for taxes that are not paid within two years of the close of the taxable year to which the taxes relate (two-year rule). In addition, section 986(a)(1)(D) provides that a taxpayer may elect to translate foreign income taxes denominated in a functional currency other than the taxpayer's functional currency using a spot rate in lieu of using the yearly average exchange rate. Section 986(a)(2)(A) generally provides that, for purposes of determining the amount of the foreign tax credit with respect to any foreign income taxes not subject to section 986(a)(1)(A) (or section 986(a)(1)(E), which provides a special rule for regulated investment companies), including by reason of the two-year rule or an election under section 986(a)(1)(D), the taxes are translated into dollars using the spot rate on the date such taxes were paid. Adjustments to such taxes are subject to the same rule, except that any refund or credit is translated into dollars using the exchange rate that applied to the original payment of such foreign income taxes.

Taking into account the translation rules of § 1.987–3(c) and section 986(a), a mismatch could arise between the owner functional currency value of income used to pay foreign income taxes and the owner functional currency value of the foreign income taxes claimed as a credit. In the case of foreign income taxes deemed paid under section 902, section 78 generally prevents such a mismatch at the level of the domestic shareholder claiming the credit by requiring the domestic shareholder to include in income an amount equal to the taxes deemed paid, but where a U.S. person claims a credit under section 901 that is not for taxes deemed paid under section 902 or section 960, foreign income taxes and the income used to pay those taxes could be translated at different translation rates. To address this potential mismatch, Notice 89–74, 1989–1 C.B. 739, provides that when a U.S. taxpayer with a foreign branch that has a functional currency other than the dollar claims a foreign tax credit with respect to a foreign tax, the taxpayer is required to translate a functional currency amount equal to the foreign taxes paid on branch income using the exchange rate at the time of payment of such taxes.

Consistent with Notice 89–74, § 1.987–3T(c)(2)(v) includes a special translation rule providing that income in an amount equal to the functional currency amount of the section 987 QBU's foreign income taxes claimed as a credit must be translated at the same rate used to translate the taxes. This translation rule applies to the owner of a section 987 QBU claiming a credit under section 901 for foreign income taxes, other than income taxes deemed paid under section 902 or section 960, that are properly reflected on the books of the section 987

QBU. Mechanically, this rule requires the owner to reduce the amount of section 987 taxable income or loss that otherwise would be determined under § 1.987–3 by an amount equal to the creditable tax amount, translated into U.S. dollars at the yearly average exchange rate for the taxable year in which the creditable tax is accrued, and then to increase the resulting amount by an amount equal to the creditable tax amount translated into U.S. dollars at the same exchange rate used to translate the creditable taxes into U.S. dollars under section 986(a). If the foreign taxes and the income are both translated at the same rate (that is, the same yearly average exchange rate), no adjustment is necessary under § 1.987–3T(c)(2)(v).

8. *Determination of a Partner's Share of Assets and Liabilities of a Section 987 Aggregate Partnership*

As discussed in the preamble to the final regulations, the final regulations apply an aggregate approach with respect to section 987 aggregate partnerships, which are defined in § 1.987–1(b)(5) as partnerships for which all of the capital and profits interests are owned, directly or indirectly, by persons that are related within the meaning of section 267(b) or section 707(b). This approach is consistent with the aggregate approach to partnerships reflected in the 2006 proposed regulations, but the 2006 proposed regulations would have applied to all partnerships. Under the aggregate approach, assets and liabilities reflected on the books and records of an eligible QBU of a partnership are allocated to each partner, which is considered an indirect owner of the eligible QBU. If the eligible QBU has a different functional currency than its indirect owner, then the assets and liabilities of the eligible QBU that are allocated to the partner are treated as a section 987 QBU of the indirect owner.

The 2006 proposed regulations provided a rule for determining a partner's share of the assets and liabilities of an eligible QBU that is owned indirectly through a section 987 aggregate partnership. Specifically, proposed § 1.987–7(b) provided that a partner's share of assets and liabilities reflected on the books and records of an eligible QBU owned through a section 987 aggregate partnership must be determined in a manner consistent with how the partners have agreed to share the economic benefits and burdens corresponding to partnership assets and liabilities, taking into account the rules and principles of subchapter K. One comment noted that this rule for allocating assets and liabilities to a partner's indirectly owned section 987 QBU was ambiguous and that the rules and principles of subchapter K do not provide sufficient guidance in this regard.

The Treasury Department and the IRS acknowledge the ambiguity in the 2006 proposed regulations regarding the manner in which assets and liabilities of a partnership are allocated to a partner's indirectly owned section 987 QBU under the aggregate approach. Accordingly, the temporary regulations provide more specific rules for determining a partner's share of the assets and liabilities reflected on the books and records of an eligible QBU owned indirectly through a section 987 aggregate partnership. Specifically, § 1.987–7T(b) provides that, in any taxable year, a partner's share of each asset and liability of a section 987

aggregate partnership is proportional to the partner's liquidation value percentage with respect to the aggregate partnership. A partner's liquidation value percentage is defined as the ratio of the liquidation value of the partner's interest in the partnership to the aggregate liquidation value of all the partners' interests in the partnership. The liquidation value of the partner's interest in the partnership is the amount of cash the partner would receive with respect to its interest if, immediately following the applicable determination date, the partnership sold all of its assets for cash equal to the fair market value of such assets (taking into account section 7701(g)), satisfied all of its liabilities (other than those described in § 1.752–7), paid an unrelated third party to assume all of its § 1.752–7 liabilities in a fully taxable transaction, and then liquidated.

In general, the temporary regulations provide that the determination date for determining a partner's liquidation value percentage is the date of the most recent event described in § 1.704–1(b)(2)(iv)(*f*)(*5*) or § 1.704–1(b)(2)(iv)(*s*)(*1*) (a revaluation event), irrespective of whether the capital accounts of the partners are adjusted under § 1.704–1(b)(2)(iv)(*f*), or, if there has been no revaluation event, the date of the formation of the partnership. However, if a partnership agreement provides for the allocation of any item of income, gain, deduction, or loss from partnership property to a partner other than in accordance with the partner's liquidation value percentage in a particular taxable year, the determination date is the last day of the partner's taxable year, or, if the partner's section 987 QBU owned indirectly through a section 987 aggregate partnership terminates during the partner's taxable year, the date such section 987 QBU is terminated. Without this requirement to redetermine liquidation value percentages at year-end when such an allocation is in effect, the allocation could result in section 987 taxable income or loss, which necessarily would reflect the allocation, being taken into account in determining section 987 gain or loss under § 1.987–4 even though the allocation was not taken into account in computing the owner functional currency value of the section 987 QBU, such that distortions would arise in the computation of section 987 gain or loss.

The Treasury Department and the IRS have determined that the liquidation value percentage methodology reflected in § 1.987–7T(b) reflects an administrable approach to allocating assets and liabilities of a section 987 aggregate partnership to eligible QBUs of its partners in a manner consistent with the partners' economic interests in the assets and liabilities of the partnership. The Treasury Department and the IRS request comments on the application of the liquidation value percentage approach reflected in the temporary regulations, including whether any alternative measure could better satisfy the criteria of administrability and consistency with the economics of the partners' arrangement.

9. *Deferral of Certain Section 988 Loss Realized by a Debtor with Respect to a Related-party Loan*

Section 267(a)(1) provides that no deduction is allowed in respect of any loss from the sale or exchange of property, directly or indirectly, between persons who have a relationship described in section 267(b). Section 267(f)(2) modifies the general rule of section 267(a)(1) in the case of a sale or exchange of property between corporations that are members of the same controlled group (as defined in section 267(f)(1)), generally providing that a loss realized upon such a sale or exchange is deferred until the property is transferred outside the group such that there would be recognition of loss under consolidated return principles. Section 267(f)(3)(C) provides that, to the extent provided in regulations, section 267(a)(1) does not apply to any loss sustained by a member of a controlled group on the repayment of a loan made to another member of such controlled group if such loan is payable or denominated in a foreign currency and attributable to a reduction in the value of that foreign currency. Section 1.267(f)–1(e) provides that section 267(a) generally does not apply to an exchange loss realized with respect to a loan of nonfunctional currency to another controlled group member if the transaction that causes the realization of the loss does not have as a significant purpose the avoidance of Federal income tax. Additionally, § 1.267(f)–1(h) provides that if a transaction is engaged in with a principal purpose to avoid the purposes of § 1.267(f)–1, including by distorting the timing of losses, adjustments may be made to carry out such purposes. Section 1.988–2(b)(16)(i) cross-references the regulations under section 267 regarding the coordination of sections 267 and 988 with respect to the treatment of a creditor under a debt instrument, but § 1.988–2(b)(16)(ii) is reserved with respect to the treatment of a debtor. The temporary regulations correct the cross-reference in § 1.988–2(b)(16)(i) to refer to § 1.267(f)–1(e) rather than § 1.267(f)–1(h).

The Treasury Department and the IRS have determined that the policy considerations underlying section 267(f)(3)(C) and § 1.267(f)–1(e) with respect to creditors on loans to related persons also apply with respect to debtors on such loans and that there is no reason to distinguish between a creditor and debtor with regard to the application of an anti-avoidance rule to the same transaction. Accordingly, pursuant to the authority granted to the Secretary in section 989(c)(5) to prescribe regulations providing for the appropriate treatment of related-party transactions, § 1.988–2T(b)(16)(ii) provides that exchange loss of a debtor with respect to a loan (original loan) from a person with whom the debtor has a relationship described in section 267(b) or section 707(b) is deferred if the transaction resulting in realization of the loss has a principal purpose of avoiding Federal income tax. Such deferred loss will be recognized at the end of the term of the original loan.

Special Analyses

Certain IRS regulations, including these, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory assessment is not required. For applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), please refer to the Special Analyses section in the preamble to the cross-referenced notice of proposed

rulemaking in the Proposed Rules section of this issue of the **Bulletin.** Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Mark E. Erwin of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Amendment to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 985, 987, 989(c) and 7805 * * *

Par. 2. Section 1.987–0 is amended by adding entries for §§ 1.987–6(b)(4)and 1.987–12(a) through (h) to read as follows:

§ 1.987–0 Section 987; table of contents.

* * * * *

§ 1.987–6 Character and source of section 987 gain or loss.

* * * * *

(b) * * *

(4) [Reserved].

* * * * *

§ 1.987–12 Deferral of section 987 gain or loss.

(a) through (h) [Reserved].

Par. 3. Section 1.987–1 is amended by adding paragraphs (b)(1)(iii), (b)(6), (c)(1)(ii)(B), (c)(3)(i)(E), (d)(3), (f), (g)(2)(i)(B) and (C), and (g)(3)(i)(E) through (H) to read as follows:

§ 1.987–1 Scope, definitions, and special rules.

* * * * *

(b) * * *

(1) * * *

(iii) [Reserved]. For further guidance, see § 1.987–1T(b)(1)(iii).

* * * * *

(b) * * *

(6) [Reserved]. For further guidance, see § 1.987–1T(b)(6).

* * * * *

(c) * * *

(1) * * *

(ii) * * *

(B) [Reserved]. For further guidance, see § 1.987–1T(c)(1)(ii)(B).

* * * * *

(c) * * *

(3) * * *

(i) * * *

(E) [Reserved]. For further guidance, see § 1.987–1T(c)(3)(i)(E).

* * * * *

(d) * * *

(3) [Reserved]. For further guidance, see § 1.987–1T(d)(3).

* * * * *

(f) [Reserved]. For further guidance, see § 1.987–1T(f).

* * * * *

(g) * * *

(2) * * *

(i) * * *

(B) through (C) [Reserved]. For further guidance, see § 1.987–1T(g)(2)(i)(B) through (C).

* * * * *

(g) * * *

(3) * * *

(i) * * *

(E) through (H) [Reserved]. For further guidance, see § 1.987–1T(g)(3)(i)(E) through (H).

* * * * *

Par. 4. Section 1.987–1T is added to read as follows:

§ 1.987–1T Scope, definitions, and special rules (temporary).

(a)through (b)(1)(ii) [Reserved]. For further guidance, see § 1.987–1(a) through (b)(1)(ii).

(iii) *Certain provisions applicable to all taxpayers*. Notwithstanding § 1.987–1(b)(1)(ii), paragraphs (b)(6) and (g)(3)(i)(E) of this section and § 1.987–6T(b)(4) apply to any taxpayer that is an owner of a dollar QBU (as defined in paragraph (b)(6) of this section), and paragraphs (g)(2)(i)(B) and (g)(3)(i)(H) of this section and §§ 1.987–8T(d) and 1.987–12T apply to any taxpayer that is an owner of an eligible QBU (determined without regard to § 1.987–1(b)(3)(ii)) that is subject to section 987.

(b)(2) through (b)(5) [Reserved]. For further guidance, see § 1.987–1(b)(2) through (b)(5).

(6) *Dollar QBUs*—(i) *In general*. Except as provided in paragraphs (b)(1)(iii) and (b)(6)(iii) of this section, section 987 and the regulations thereunder do not apply with respect to an eligible QBU (determined without regard to § 1.987–1(b)(3)(ii)) that has the U.S. dollar as its functional currency and that would be subject to section 987 if it had a functional currency other than the dollar (dollar QBU). This paragraph (b)(6) applies to all taxpayers, including entities described in § 1.987–1(b)(1)(ii).

(ii) *Application of section 988 to a dollar QBU*—(A) *In general*. Except as provided in paragraphs (b)(6)(ii)(B) and (b)(6)(iii) of this section, a controlled foreign corporation (as defined in section 957(a)) (CFC) that is the owner of a dollar QBU applies section 988 with respect to any item that is properly reflected on the books and records of the dollar QBU and that would give rise to a section 988 transaction if such item were acquired, accrued, or entered into directly by the owner of the dollar QBU. Except as provided in paragraph (b)(6)(ii)(B) of this section, for purposes of determining the amount of section 988 gain or loss of the CFC, any item that is properly reflected on the books and records of the dollar QBU and that would give rise to a section 988 transaction if such item were acquired, accrued, or entered into directly by the owner of the dollar QBU is treated as properly reflected on the books and records of the owner of the dollar QBU, such that the amount of section 988 gain or loss with respect to such item is determined by reference to the owner's functional currency.

(B) *Section 988 gain or loss characterized as effectively connected income*. Solely for the purpose of determining the amount of section 988 gain or loss of a CFC described in paragraph (b)(6)(ii)(A) of this section that is effectively connected with the conduct of a trade or business within the United States (ECI), any section 988 gain or loss that would be determined under section 988 as a result of the acquisition or accrual of any item and treated as ECI under § 1.988–4(c) if the item were treated as properly reflected on the books and records of the

dollar QBU is determined by treating such item as properly reflected on the books and records of the dollar QBU. Consequently, solely for that purpose, such section 988 gain or loss is determined by reference to the U.S. dollar.

(iii) *Election for a CFC to apply section 987 to a dollar QBU*—(A) *In general*. A CFC that is the owner of a dollar QBU may elect to apply section 987 and the regulations thereunder with respect to the dollar QBU in lieu of applying section 988 pursuant to paragraph (b)(6)(ii) of this section. If the dollar QBU or CFC is described in § 1.987–1(b)(1)(ii), however, the CFC must apply section 987 to the dollar QBU using the method it applied to the dollar QBU immediately prior to the effective date of this paragraph (b)(6) as provided in paragraph (h) of this section, provided such method was a reasonable interpretation of section 987, or, if no such method exists, a reasonable method.

(B) *Section 988 gain or loss characterized as effectively connected income*. Solely for the purpose of determining the amount of section 988 gain or loss of a dollar QBU that is the subject of an election described in paragraph (b)(6)(iii)(A) of this section that is ECI, § 1.987–3T(b)(4)(i) and (ii) do not apply, and any section 988 gain or loss that would be determined under section 988 as a result of the acquisition or accrual of any item and treated as ECI under § 1.988–4(c) if the item were treated as properly reflected on the books and records of the dollar QBU is determined by treating such item as properly reflected on the books and records of the dollar QBU. Consequently, solely for that purpose, such section 988 gain or loss is determined by reference to the U.S. dollar. See § 1.987–6T(b)(4) for rules regarding the source of section 987 gain or loss with respect to a dollar QBU for which the CFC owner has made the election described in this paragraph.

(b)(7) through (c)(1)(ii)(A) [Reserved]. For further guidance, see § 1.987–1(b)(7) through (c)(1)(ii)(A).

(B) *Election inapplicable with respect to certain amounts*. Except as provided in this paragraph (c)(1)(ii)(B), the election provided in § 1.987–1(c)(1)(ii)(A) does not apply for purposes of determining section 987 taxable income or loss (as defined in § 1.987–3(a)) with respect to a historic item (as defined in § 1.987–1(e)) if acquiring, accruing, or entering into such item gives rise to a section 988 transaction or specified owner functional currency transaction. However, the election provided in § 1.987–1(c)(1)(ii)(A) does apply for purposes of determining section 987 taxable income or loss with respect to a payable or receivable described in § 1.988–1(d)(3) under the circumstances described in § 1.988–1(d)(3).

(c)(2) through (c)(3)(i)(D) [Reserved]. For further guidance, see § 1.987–1(c)(2) through (c)(3)(i)(D).

(E) *Section 988 transactions and specified owner functional currency transactions*. If acquiring, accruing, or entering into a historic item gives rise to a section 988 transaction of a section 987 QBU or a specified owner functional currency transaction described in § 1.987–3T(b)(4)(ii), the historic rate is the spot rate (as defined in paragraph (c)(1) of this section) on the date such item is acquired,

accrued, or entered into. For this purpose, use of a spot rate convention under § 1.987–1(c)(1)(ii) is permitted only with respect to a payable or receivable described in § 1.988–1(d)(3) and only to the extent provided therein.

(c)(3)(ii) through (d)(2) [Reserved]. For further guidance, see § 1.987–1(c)(3)(ii) through (d)(2).

(3) Gives rise to a qualified short-term section 988 transaction (as defined in § 1.987–3T(b)(4)(iii)(B)) of the section 987 QBU, whether denominated in the functional currency of the owner or other nonfunctional currency with respect to the section 987 QBU, for which section 988 gain or loss is determined under § 1.987–3T(b)(4)(iii)(A) in, and by reference to, the functional currency of the section 987 QBU.

(e) [Reserved]. For further guidance, see § 1.987–1(e).

(f) *Examples*. The following examples illustrate the application of § 1.987–1(d) and (e).

Example 1. U.S. Corp is a domestic corporation with the U.S. dollar as its functional currency and is the owner of Business A, a section 987 QBU that has the pound as its functional currency. Assume all transactions of Business A are entered into in the ordinary course of its business. U.S. Corp has not made an election under § 1.987–3T(b)(4)(iii)(C) to adopt a foreign currency mark-to-market method of accounting for qualified short-term section 988 transactions. Items reflected on Business A's balance sheet include £10,000, $1,000, a building with a basis of £100,000, a light general purpose truck with a basis of £30,000, a computer with a basis of £1,000, a 60-day receivable for ¥15,000, an account payable of £5,000, and a foreign currency contract within the meaning of section 1256(g)(2) that requires Business A to exchange £100 for $125 in 90 days. Under paragraph (d) of this section, the £10,000, the £5,000 account payable and the £/$ section 1256 foreign currency contract are marked items. The other items are historic items under this paragraph (e) of this section.

Example 2. The facts are the same as *Example 1* except that U.S. Corp has elected under § 1.987–3T(b)(4)(iii)(C) to adopt the foreign currency mark-to-market method of accounting for qualified short-term section 988 transactions of Business A. Under paragraphs (d) and (e) of this section, the £10,000, the $1,000, the ¥15,000 receivable, the £5,000 account payable, and the £/$ section 1256 foreign currency contract are marked items.

(g)(1) through (g)(2)(i)(A) [Reserved]. For further guidance, see § 1.987–1(g)(1) through (g)(2)(i)(A).

(B) *Annual deemed termination election*—(*1*) *In general*. Except as provided in paragraph (g)(2)(i)(B)(*2*) of this section, an election under § 1.987–8T(d) (annual deemed termination election) applies to all section 987 QBUs owned by the taxpayer, as well as to all section 987 QBUs owned by any person that has a relationship to the taxpayer described in section 267(b) or section 707(b) (substituting "and the profits interest" for "or the profits interest" in section 707(b)(1)(A) and substituting "and profits interests" for "or profits interests" in

section 707(b)(1)(B)) on the last day of the first taxable year for which the election applies (a related person). If a taxpayer makes the election under § 1.987–8T(d), the first taxable year of a related person for which the election applies is the first taxable year that ends with or within a taxable year of the taxpayer for which the taxpayer's election applies. An election under § 1.987–8T(d) may not be revoked**.**

(*i*) *Fresh start taxpayers*. A taxpayer to which § 1.987–10 applies that is required under § 1.987–10(a) to apply the fresh start transition method described in § 1.987–10(b) (fresh start taxpayer) may make the election under § 1.987–8T(d) only if the first taxable year for which the election would apply to the taxpayer is either the first taxable year beginning on or after the transition date (as defined in § 1.987–11(c)) in which the election is relevant or a subsequent taxable year in which the taxpayer's controlled group aggregate section 987 loss, if any, does not exceed $5 million. For purposes of this paragraph (g)(2)(i)(B), a taxpayer's controlled group aggregate section 987 loss means the aggregate net amount of section 987 loss that would be recognized pursuant to the election by the taxpayer and all other persons to whom the taxpayer's election would apply in the first taxable year of each person for which the election would apply.

(*ii*) *Other taxpayers*. Other taxpayers, including taxpayers described in § 1.987–1(b)(1)(ii) and taxpayers described in § 1.987–10(c), must follow the election rules provided in paragraph (g)(2)(i)(B)(*1*)(*i*) of this section if any related party is a fresh start taxpayer. If no related party is a fresh start taxpayer, the election under § 1.987–8T(d) may be made only if the first taxable year for which the election would apply to the taxpayer is either the first taxable year beginning on or after December 7, 2016, in which the election is relevant or a subsequent taxable year in which the taxpayer's controlled group aggregate section 987 loss, if any, does not exceed $5 million.

(*2*) *QBU-by-QBU elections in certain circumstances*. Notwithstanding paragraph (g)(2)(i)(B)(*1*) of this section, a taxpayer may make a separate election under § 1.987–8T(d) with respect to any section 987 QBU owned by the taxpayer if the first taxable year for which the election would apply to the taxpayer with respect to the section 987 QBU is a taxable year in which there is a section 987 gain recognized with respect to the section 987 QBU pursuant to the election, or is a taxable year in which there is a section 987 loss of $1 million or less that would be recognized with respect to the section 987 QBU pursuant to the election

(C) *Election to translate all items at the yearly average exchange rate*. An election under § 1.987–3T(d) (election to translate all items at the yearly average exchange rate) may be made with respect to a section 987 QBU only if the first taxable year for which the election would apply is the first taxable year for which an election under § 1.987–8T(d) (annual deemed termination election) applies with respect to the section 987 QBU.

(g)(2)(ii) through (g)(3)(i)(D) [Reserved]. For further guidance, see § 1.987–1(g)(2)(ii) through (g)(3)(i)(D).

(E) *Election for a CFC to apply section 987 to a dollar QBU*. An election under § 1.987–1T(b)(6)(iii) for a CFC to apply section 987 to a dollar QBU must be titled "Section 987 Election for a CFC to Apply Section 987 to a Dollar QBU Under § 1.987–1T(b)(6)(iii)" and must provide the name and address of each QBU for which the election is being made.

(F) *Election to apply the foreign currency mark-to-market method of accounting for qualified short-term section 988 transactions*. An election under § 1.987–3T(b)(4)(iii)(C) to apply the foreign currency mark-to-market method of accounting for qualified short-term section 988 transactions must be titled "Section 987 Election to Use Foreign Currency Mark-to-Market Method of Accounting for Qualified Short-Term Section 988 Transactions Under § 1.987–3(b)T(4)(iii)(C)" and must provide the name and address of each section 987 QBU for which the election is being made.

(G) *Election to translate all items at the yearly average exchange rate*. An election under § 1.987–3T(d) to translate all items at the yearly average exchange rate must be titled "Section 987 Election to Translate All Items at the Yearly Average Exchange Rate Under § 1.987–3T(d)" and must provide the name and address of each section 987 QBU for which the election is being made.

(H) *Annual deemed termination election*. An election under § 1.987–8T(d) for an owner to deem all of its section 987 QBUs to terminate on the last day of each taxable year must be titled "Section 987 Annual Deemed Termination Election Under § 1.987–8T(d)" and must provide the name and address of each section 987 QBU to which the election applies, including a section 987 QBU owned by a related person (within the meaning of paragraph (g)(2)(i)(B)(*1*) of this section).

(g)(4) through (6) [Reserved]. For further guidance, see § 1.987–1(g)(4) through (6).

(h) *Effective/applicability date*. Paragraphs (g)(2)(i)(B) and (g)(3)(i)(H) of this section apply to the first taxable year beginning on or after December 7, 2016. Paragraphs (b)(1)(iii), (b)(6), (c)(1)(ii)(B), (c)(3)(i)(E), (d)(3), (f), (g)(2)(i)(C), and (g)(3)(i)(E) through (G) of this section apply to taxable years beginning one year after the first day of the first taxable year following December 7, 2016. Notwithstanding the preceding sentence, if a taxpayer makes an election under § 1.987–11(b), then paragraphs (b)(1)(iii), (b)(6), (c)(1)(ii)(B), (c)(3)(i)(E), (d)(3), (f), (g)(2)(i)(C), and (g)(3)(i)(E) through (G) of this section apply to taxable years to which §§ 1.987–1 through 1.987–10 apply as a result of such election.

(i) *Expiration date*. The applicability of this section expires on December 6, 2019.

Par. 5. Section 1.987–2 is amended by adding paragraph (c)(9) to read as follows:

§ 1.987–2 Attribution of items to eligible QBUs; definition of a transfer and related rules.

* * * * *

(c) * * *

(9) [Reserved]. For further guidance, see § 1.987–2T(c)(9).

* * * * *

Par. 6. Section 1.987–2T is added to read as follows:

§ 1.987–2T Attribution of items to eligible QBUs; definition of a transfer and related rules (temporary).

(a) through (c)(8) [Reserved]. For further guidance, see § 1.987–2(a) through (c)(8).

(9) *Certain disregarded transactions not treated as transfers*—(i) *Combinations of section 987 QBUs*. The combination of two or more separate section 987 QBUs (combining QBUs) that are directly owned by the same owner, or that are indirectly owned by the same partner through a single section 987 aggregate partnership, into one section 987 QBU (combined QBU) does not give rise to a transfer of any combining QBU's assets or liabilities to the owner under § 1.987–2(c). In addition, transactions between the combining QBUs occurring in the taxable year of the combination do not result in a transfer of the combining QBUs' assets or liabilities to the owner under § 1.987–2(c). For this purpose, a combination occurs when the assets and liabilities that are properly reflected on the books and records of two or more combining QBUs begin to be properly reflected on the books and records of a combined QBU and the separate existence of the combining QBUs ceases. A combination may result from any transaction or series of transactions in which the combining QBUs become a combined QBU. For rules regarding the determination of net unrecognized section 987 gain or loss of a combined QBU, see § 1.987–4T(f)(1).

(ii) *Change in functional currency from a combination*. If, following a combination of section 987 QBUs described in paragraph (c)(9)(i) of this section, the combined section 987 QBU has a different functional currency than one or more of the combining section 987 QBUs, any such combining section 987 QBU is treated as changing its functional currency and the owner of the combined section 987 QBU must comply with the regulations under section 985 regarding the change in functional currency. See §§ 1.985–1(c)(6) and 1.985–5.

(iii) *Separation of section 987 QBUs*. The separation of a section 987 QBU (separating QBU) into two or more section 987 QBUs (separated QBUs) that, after the separation, are directly owned by the same owner, or that are indirectly owned by the same partner through a single section 987 aggregate partnership, does not give rise to a transfer of the separating QBU's assets or liabilities to the owner under § 1.987–2(c). Additionally, transactions that occurred between the separating QBUs in the taxable year of the separation prior to the completion of the separation do not give rise to transfers for purposes of section 987. For this purpose, a separation occurs when the assets and liabilities that are properly reflected on the books and records of a separating QBU begin to be properly reflected on the books and records of two or more separated QBUs. A separation may result from any transaction or series of transactions in which a separating QBU becomes two or more separated

QBUs. A separation may also result when a section 987 QBU that is subject to a grouping election under § 1.987–1(b)(2)(ii)(A) changes its functional currency. For rules regarding the determination of net unrecognized section 987 gain or loss of a separated QBU, see § 1.987–4T(f)(2).

(c)(10) through (d) [Reserved]. For further guidance see § 1.987–2(c)(10) through (d).

(e) *Effective/applicability date*. This section applies to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. Notwithstanding the preceding sentence, if a taxpayer makes an election under § 1.987–11(b), then this section applies to taxable years to which §§ 1.987–1 through 1.987–10 apply as a result of such election.

(f) *Expiration date*. The applicability of this section expires on December 6, 2019.

Par. 7. Section 1.987–3 is amended by adding paragraphs (b)(2)(ii), (b)(4), (c)(2)(ii) and (v), and (d), and *Example 9* through *Example 14* at the end of paragraph (e) to read as follows:

§ 1.987–3 Determination of section 987 taxable income or loss of an owner of a section 987 QBU.

* * * * *

(b) * * *

(2) * * *

(ii) [Reserved]. For further guidance, see § 1.987–3T(b)(2)(ii).

* * * * *

(b) * * *

(4) [Reserved]. For further guidance, see § 1.987–3T(b)(4).

* * * * *

(c) * * *

(2) * * *

(ii) [Reserved]. For further guidance, see § 1.987–3T(c)(2)(ii).

* * * * *

(c) * * *

(2) * * *

(v) through (d) [Reserved]. For further guidance, see § 1.987–3T(c)(2)(v) through (d).

(e) *Examples*. * * *

Example 9 through *Example 14* [Reserved]. For further guidance, see § 1.987–3T(e), *Example 9* through *Example 14*.

Par. 8. Section 1.987–3T is added to read as follows:

§ 1.987–3T Determination of section 987 taxable income or loss of an owner of a section 987 QBU (temporary).

(a) through (b)(2)(i) [Reserved]. For further guidance, see § 1.987–3(a) through (b)(2)(i).

(ii) *No translation of basis or amount realized with respect to a specified owner functional currency transaction treated as a historic asset*. If the acquisition of a historic asset gives rise to a specified owner functional currency transaction described in paragraph (b)(4)(ii) of this section, the basis of the historic asset, and any amount realized on a disposition of the historic asset, is not translated if the amount is denominated in the owner's functional currency.

(3) [Reserved]. For further guidance, see § 1.987–3(b)(3).

(4) *Special rule for section 988 transactions*—(i) *In general*. Section 988 and the regulations thereunder apply to section 988 transactions of a section 987 QBU. For this purpose, whether a transaction is a section 988 transaction is determined by reference to the functional currency of the section 987 QBU. (But see paragraph (b)(4)(ii) of this section, providing that specified owner functional currency transactions are not treated as section 988 transactions.) However, except as provided in paragraph (b)(4)(iii)(A) of this section, section 988 gain or loss is determined in, and by reference to, the functional currency of the owner of the section 987 QBU rather than the functional currency of the section 987 QBU. Accordingly, in determining section 988 gain or loss of a section 987 QBU with respect to a section 988 transaction of the section 987 QBU, the amounts required under section 988 and the regulations thereunder to be translated on the applicable booking date or payment date with respect to the section 988 transaction are translated into the owner's functional currency at the rate required under section 988 and the regulations thereunder.

(ii) *Specified owner functional currency transactions not treated as section 988 transactions*. Transactions of a section 987 QBU described in sections 988(c)(1)(B)(i), 988(c)(1)(B)(ii), and 988(c)(1)(C) (including the acquisition of nonfunctional currency as described in § 1.988–1(a)(1)), other than transactions described in paragraph (b)(4)(iii)(A) of this section, that are denominated in (or determined by reference to) the owner's functional currency (specified owner functional currency transactions) are not treated as section 988 transactions. Thus, no currency gain or loss is recognized by a section 987 QBU under section 988 with respect to such transactions.

(iii) *Determination of section 988 gain or loss for qualified short-term section 988 transactions*—(A) *Determination by reference to the section 987 QBU's functional currency for certain transactions subject to a mark-to-market method of accounting*. Section 988 gain or loss with respect to section 988 transactions

described in paragraph (b)(4)(iii)(B) of this section that are accounted for under a mark-to-market method of accounting for Federal income tax purposes or under the foreign currency mark-to-market method of accounting described in paragraph (b)(4)(iii)(C) of this section, and any hedges entered into to manage risk with respect to such transactions within the meaning of § 1.1221–2(c)(4) (related hedges), must be determined in, and by reference to, the functional currency of the section 987 QBU (rather than the functional currency of its owner).

(B) *Qualified short-term section 988 transaction*. A qualified short-term section 988 transaction is a section 988 transaction that occurs in the ordinary course of a section 987 QBU's business and has an original term of one year or less on the date the transaction is entered into by the section 987 QBU. The holding of currency that is nonfunctional currency (within the meaning of section 988(c)(1)(C)(ii)) to the section 987 QBU in the ordinary course of a section 987 QBU's trade or business also is treated as a qualified short-term section 988 transaction. Any transaction that is denominated in, or determined by reference to, a hyperinflationary currency, including the holding of hyperinflationary currency, is not considered a qualified short-term section 988 transaction. See §§ 1.988–2(b)(15), 1.988–2(d)(5), and 1.988–2(e)(7) for rules relating to transactions denominated in, or determined by reference to, a hyperinflationary currency.

(C) *Election to use a foreign currency mark-to-market method of accounting*. A taxpayer may elect under this paragraph (b)(4)(iii)(C) to apply the foreign currency mark-to-market method of accounting described in this paragraph for all qualified short-term section 988 transactions described in paragraph (b)(4)(iii)(B) of this section, and any related hedges, that are properly attributable to a section 987 QBU on or after the effective date of the election and that are not otherwise accounted for under a mark-to-market method of accounting under section 475 or section 1256. Under the foreign currency mark-to-market method of accounting, the timing of section 988 gain or loss on section 988 transactions is determined under the principles of section 1256(a)(1). Thus, only section 988 gain or loss is taken into account under the foreign currency mark-to-market method of accounting. Appropriate adjustments must be made to prevent the section 988 gain or loss from being taken into account again under section 988 or another provision of the Code or regulations. A section 988 transaction subject to this election is not subject to the "netting rule" of section 988(b) and § 1.988–2(b)(8), under which exchange gain or loss is limited to overall gain or loss realized in a transaction, in taxable years prior to the taxable year in which section 988 gain or loss would be recognized with respect to such section 988 transaction but for this election.

(iv) *Examples*. Examples 10 through 13 of paragraph (e) of this section illustrate the application of this paragraph (b)(4).

(c)(1) through (c)(2)(i) [Reserved]. For further guidance, see § 1.987–3(c)(1) through (c)(2)(i).

(ii) *Amount realized with respect to historic assets that are section 988 transactions*. If the acquisition of a historic asset gave rise to a section 988 transaction described in paragraph (b)(4)(i) of this section, then in computing the total gain or loss on a disposition of the historic asset (some or all of which total gain or loss may be section 988 gain or loss described in section 988(b) and paragraph (b)(4)(i) of this section), the amount realized (determined, if necessary, under § 1.987–3(b)(2)(i)) is translated into the owner's functional currency using the spot rate on the date such item is properly taken into account, subject to the limitation under § 1.987–1T(c)(1)(ii)(B) regarding the use of a spot rate convention.

(iii) through (iv) [Reserved]. For further guidance, see § 1.987–3(c)(2)(iii) through (iv).

(v) *Translation of income to account for certain foreign income tax claimed as a credit*. The owner of a section 987 QBU claiming a credit under section 901 for foreign income taxes, other than foreign income taxes deemed paid under section 902 or section 960, that are properly reflected on the books and records of the section 987 QBU (the creditable tax amount) must determine section 987 taxable income or loss attributable to the section 987 QBU by reducing the amount of section 987 taxable income or loss that otherwise would be determined under this section by an amount equal to the creditable tax amount, translated into U.S. dollars using the yearly average exchange rate for the taxable year in which the creditable tax is accrued, and by increasing the resulting amount by an amount equal to the creditable tax amount, translated using the same exchange rate that is used to translate the creditable taxes into U.S. dollars under section 986(a). See *Example 14* of paragraph (e) of this section, , for an illustration of this rule.

(d) *Election to translate all items at the yearly average exchange rate*. Notwithstanding § 1.987–3(c), a taxpayer that has made the annual deemed termination election described in § 1.987–8T(d) may elect under this paragraph (d) to translate all items of income, gain, deduction, and loss with respect to a section 987 QBU determined under § 1.987–3(b) in the functional currency of the section 987 QBU into the owner's functional currency, if necessary, at the yearly average exchange rate for the taxable year. *Example 9* of paragraph (e) of this section illustrates the application of this election.

(e) *Example 1* through *Example 8* [Reserved]. For further guidance, see § 1.987–3(e), *Example 1* through *Example 8*.

Example 9. The facts are the same as in *Example 7,* except that U.S. Corp properly elects under paragraph (d) of this section to translate all items of income, gain, deduction, and loss with respect to Business A at the yearly average exchange rate. Accordingly, Business A's €2,000 gain on the sale of the land is translated at the yearly average exchange rate for 2021 of €1 = $1.05, and the amount of gain reported by U.S. Corp on the sale of the land is $2,100.

Example 10. Business A acquires £100 on August 27, 2021, for €120 and sells the pounds on November 17, 2021, for €125. The dollar-pound spot rate (without the use of a spot rate convention) is £1 = $1 on August 27, 2021, and £1 = $1.10 on November 17, 2021. The disposition of the pounds is a section 988 transaction of Business A under paragraph (b)(4)(i) of this section, and the pounds are a historic asset under § 1.987–1(e). Section 988 gain or loss with respect to the disposition of the pounds is determined under paragraph (b)(4)(i) of this section and § 1.988–2(a)(2) by reference to the dollar functional currency of Business A's owner. The dollar amount realized for the pounds is determined under paragraph (c)(2)(ii) of this section by translating £100 into $110 using the dollar-pound spot rate on November 17, 2021, without the use of a spot rate convention. The dollar basis in the pounds is determined under § 1.987–3(c)(2)(i) by translating £100 into $100 using the historic rate described in § 1.987–1T(c)(3)(i)(E), which is the dollar-pound spot rate on August 27, 2021, without the use of a spot rate convention. Thus, U.S. Corp takes into account $10 of section 988 gain with respect to Business A's disposition of £100.

Example 11. (i) Business A purchases a £100 2-year note for €75 on October 1, 2021, and receives a £100 repayment of principal with respect to the note on December 31, 2021. At the spot rates on October 1, 2021 (as defined in § 1.987–1(c)(1)), without the use of a spot rate convention, Business A's €75 purchase price translates into £80 and $95. At the spot rates on December 31, 2021, without the use of a spot rate convention, the £100 principal amount on the note translates into €90 and $130, and £80 translates into $104.

(ii) The acquisition of the note is a section 988 transaction of Business A under paragraph (b)(4)(i) of this section, and the note is a historic asset under § 1.987–1(e). To determine its section 987 taxable income or loss with respect to Business A, U.S. Corp must determine Business A's total gain or loss on the disposition of the note in U.S. Corp's dollar functional currency. Consistent with § 1.988–2(b)(8), U.S. Corp also must determine whether some or all of that gain or loss constitutes section 987 gain or loss described in section 988(b).

(iii) To determine Business A's total gain or loss on the disposition of the note, Business A's basis and amount realized on the note must be determined in euros under § 1.987–3(b), if necessary, and translated into dollars under § 1.987–3(c). Business A has a €75 basis in the note that is translated into $95 under § 1.987–3(c)(2)(i) at the historic rate described in § 1.987–1T(c)(3)(i)(E), which is the spot rate on the date the note was acquired without the use of a spot rate convention. Business A's £100 amount realized on the note is translated into €90 under § 1.987–3(b)(2)(i) using the spot rate on December 31, 2021, without the use of a spot rate convention. That €90 amount realized is then translated into $130 under paragraph (c)(2)(ii) of this section using the spot rate on December 31, 2021, without the use of a spot rate convention. Accordingly, the total gain with respect to the disposition of the note that is included in section 987 taxable income is $35 ($130 less $95).

(iv) U.S. Corp must determine whether some or all of the $35 total gain with respect to the note constitutes section 988 gain. The amount of section 988 gain realized with respect to the note is determined under § 1.988–2(b)(5), which requires a comparison of the functional currency value of the principal amount of the note on the booking date and payment date spot rates, respectively, and defines the principal amount of the note as Business A's purchase price in units of nonfunctional currency, which is £80. Under paragraph (b)(4)(i) of this section, section 988 gain or loss with respect to the note is determined by reference to U.S. Corp's dollar functional currency, such that the amounts required under section 988 to be translated on the booking date and payment date are translated into the dollars at the booking date and payment date spot rates. Accordingly, Business A's £80 principal amount with respect to the note is translated at the booking date and payment date spots rates into $95 and $104, respectively. Thus, $9 ($104 less $95) of the $35 total gain taken into account by U.S. Corp as section 987 taxable income with respect to the note is section 988 gain. The remaining $26 of gain, which may be attributable to credit risk or another factor unrelated to currency fluctuations, is sourced and characterized without regard to section 988.

Example 12. The facts are the same as in *Example 11*, except that Business A is owned by a foreign corporation with a pound functional currency. Under paragraph (b)(4)(ii) of this section, the acquisition of the £100 2-year note is a specified owner functional currency transaction that is not treated as a section 988 transaction of Business A. Because the note is a historic asset under § 1.987–1(e), Business A's €75 basis in the note translates into £80 at the historic rate described in § 1.987–1T(c)(3)(i)(E), which provides that the historic rate is the spot rate for the date the note was acquired without the use of a spot rate convention. (If, instead, Business A had purchased the 5-year note for £80 rather than €75, then pursuant to paragraph (b)(2)(ii) of this section, Business A's basis in the note would have been determined without translating the £80 purchase price because it is denominated in the owner's functional currency.) Under paragraph (b)(2)(ii) of this section, the £100 amount realized with respect to the note is not translated because it is denominated in the owner's functional currency. Thus, the owner takes into account £20 (£100 less £80) of section 987 taxable income in 2021 with respect to the note.

Example 13. (i) Business A receives and accrues $100 of income from the provision of services on January 1, 2021. Business A continues to hold the $100 as a U.S. dollar-denominated demand deposit at a bank on December 31, 2021. U.S. Corp has elected under paragraph (b)(4)(iii)(C) of this section to use the foreign currency mark-to-market method of accounting for qualified short-term section 988 transactions entered into by Business A. The euro-dollar spot rate without the use of a spot rate convention is €1 = $1 on January 1, 2021, and €1 = $2 on December 31, 2021, and the yearly average exchange rate for 2021 is €1 = $1.50.

(ii) Under § 1.987–3(b)(2)(i), the $100 earned by Business A is translated into €100 at the spot rate on January 1, 2021, as defined in § 1.987–1(c)(1) without the use of a spot rate convention. In determining U.S. Corp's taxable income, the €100 of service income is translated into $150 at the yearly average exchange rate for 2021, as provided in § 1.987–3(c)(1).

(iii) The $100 demand deposit constitutes a qualified short-term section 988 transaction under paragraph (b)(4)(iii)(B) of this section because the demand deposit is treated as nonfunctional currency within the meaning of section 988(c)(1)(C)(ii). Because Business A uses the foreign currency mark-to-market method of accounting for qualified short-term section 988 transactions, under paragraph (b)(4)(iii)(A) of this section, section 988 gain or loss for such transactions is determined in, and by reference to, euros, the functional currency of Business A. Accordingly, section 988 gain or loss must be determined on Business A's holding of the $100 demand deposit in, and by reference to, the euro. Under § 1.988–2(a)(2), Business A is treated as having an amount realized of €50 when the $100 is marked to market at the end of 2021 under paragraph (b)(4)(iii)(C) of this section. Marking the dollars to market gives rise to a section 988 loss of €50 (€50 amount realized, less Business A's €100 basis in the $100). In determining U.S. Corp's taxable income, that €50 loss is translated into a $75 loss at the yearly average exchange rate for 2021, as provided in § 1.987–3(c)(1).

Example 14. (i) *Facts*. Business A earns €100 of revenue from the provision of services and incurs €30 of general expenses and €10 of depreciation expense during 2021. Except as otherwise provided, U.S. Corp uses the yearly average exchange rate described in § 1.987–1(c)(2) to translate items of income, gain, deduction, and loss of Business A. Business A is subject to income tax in Country X at a 25 percent rate. U.S. Corp claims a credit with respect to Business A's foreign income taxes and elects under section 986(a)(1)(D) to translate the foreign income taxes at the spot rate on the date the taxes were paid. The yearly average exchange rate for 2021 is €1 = $1.50. The historic rate used to translate the depreciation expense is €1 = $1.00. The spot rate on the date that Business A paid its foreign income taxes was €1 = $1.60.

(ii) *Analysis*. Because U.S. Corp has elected to translate foreign income taxes at the spot rate on the date such taxes were paid rather than at the yearly average exchange rate, U.S. Corp must make the adjustments described in paragraph (c)(2)(v) of this section. Accordingly, U.S. Corp determines its section 987 taxable income by reducing the section 987 taxable income or loss that otherwise would be determined under this section by €15, translated into U.S. dollars at the yearly average exchange rate (€1 = $1.50), and increasing the resulting amount by €15, translated using the same exchange rate that is used to translate the creditable taxes into U.S. dollars under section 986(a) (€1 = $1.60). Following these adjustments, Business A's section 987 taxable income for 2021 is $96.50, computed as follows:

	Amount in €	***Translation Rate***	***Amount in $***
Revenue	€100	€1 = $1.50	$150.00
General Expenses	(30)	€1 = $1.50	(45.00)
Depreciation	*(10)*	€1 = $1.00	*(10.00)*
Tentative section 987 taxable income	€60		$95.00
Adjustments under paragraph (c)(2)(v) of this section:			
Decrease by €15 tax translated at yearly average exchange rate (€1 = $1.50)			($22.50)
Increase by €15 tax translated at spot rate on payment date (€1 = $1.60)			*24.00*
Section 987 taxable income			$96.50

(f) *Effective/applicability date*. This section applies to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. Notwithstanding the preceding sentence, if a taxpayer makes an election under § 1.987–11(b), then this section applies to taxable years to which §§ 1.987–1 through 1.987–10 apply as a result of such election.

(g) *Expiration date*. The applicability of this section expires on December 6, 2019.

Par. 9. Section 1.987–4 is amended by adding paragraphs (c)(2) and (f) to read as follows:

§ 1.987–4 Determination of net unrecognized section 987 gain or loss of a section 987 QBU.

* * * * *

(c) * * *

(2) [Reserved]. For further guidance, see § 1.987–4T(c)(2).

* * * * *

(f) [Reserved]. For further guidance, see § 1.987–4T(f).

* * * * *

Par. 10. Section 1.987–4T is added to read as follows:

§ 1.987–4T Determination of net unrecognized section 987 gain or loss of a section 987 QBU (temporary).

(a) through (c)(1) [Reserved]. For further guidance, see § 1.987–4(a) through (c)(1).

(2) *Coordination with § 1.987–12T*. For purposes of paragraph (c)(1) of this section, amounts taken into account under § 1.987–5 are determined without regard to § 1.987–12T.

(d) through (e) [Reserved]. For further guidance, see § 1.987–4(d) through (e).

(f) *Combinations and separations*—(1) *Combinations*. The net unrecognized section 987 gain or loss of a combined QBU (as defined in § 1.987–2T(c)(9)(i)) for a taxable year is determined under § 1.987–4(b) by taking into account the net accumulated unrecognized section 987 gain or loss of each combining QBU (as defined in § 1.987–2T(c)(9)(i)) for all prior taxable years to which the regulations under section 987 apply, as determined under § 1.987–4(c), and by treating the combining QBUs as having combined immediately prior to the beginning of the taxable year of combination.

(2) *Separations*. The net unrecognized section 987 gain or loss of a separated QBU (as defined in § 1.987–2T(c)(9)(iii)) for a taxable year is determined under § 1.987–4(b) by taking into account the separated QBU's share of the net accumulated unrecognized section 987 gain or loss of the separating QBU (as defined in § 1.987–2T(c)(9)(iii)) for all prior taxable years to which the regulations under section 987 apply, as determined under § 1.987–4(c), and by treating the separating QBU as having separated immediately prior to the beginning of the taxable year of separation. A separated QBU's share of the separating QBU's net accumulated unrecognized section 987 gain or loss for all such prior taxable years is determined by apportioning the separating QBU's net accumulated unrecognized section 987 gain or loss for all such prior taxable years to each separated QBU in proportion to the aggregate adjusted basis of the gross assets properly reflected on the books and records of each separated QBU immediately after the separation. For purposes of determining the owner functional currency net value of the separated QBUs on the last day of the taxable year preceding the taxable year of separation under § 1.987–5(d)(1)(B) and (e), the balance sheets of the separated QBUs on that day will be deemed to reflect the assets and liabilities reflected on the balance sheet of the separating QBU on that day, apportioned between the separated QBUs in a reasonable manner that takes into account the assets and liabilities reflected on the balance sheets of the separated QBUs immediately after the separation.

(3) *Examples*. The following examples illustrate the rules of paragraphs (f)(1) and (2) of this section.

Example 1. *Combination of two section 987 QBUs that have the same owner*. (i) *Facts*. DC1, a domestic corporation, owns Entity A, a DE. Entity A conducts a business in France that constitutes a section 987 QBU (French QBU) that has the euro as its functional currency. French QBU has a net accumulated unrecognized section 987 loss from all prior taxable years to which the regulations under section 987 apply of $100. DC1 also owns Entity B, a DE. Entity B conducts a business in Germany that constitutes a section 987 QBU

(German QBU) that has the euro as its functional currency. German QBU has a net accumulated unrecognized section 987 gain from all prior taxable years to which the regulations under section 987 apply of $110. During the taxable year, Entity A and Entity B merge under local law. As a result, the books and records of French QBU and German QBU are combined into a new single set of books and records. The combined entity has the euro as its functional currency.

(ii) *Analysis*. Pursuant to § 1.987–2T(c)(9)(i), French QBU and German QBU are combining QBUs, and their combination does not give rise to a transfer that is taken into account in determining the amount of a remittance (as defined in § 1.987–5(c)). For purposes of computing net unrecognized section 987 gain or loss under § 1.987–4 for the year of the combination, the combination is deemed to have occurred on the last day of the owner's prior taxable year, such that the owner functional currency net value of the combined section 987 QBU at the end of that taxable year described under § 1.987–4(d)(1)(B) takes into account items reflected on the balance sheets of both French QBU and German QBU at that time. Additionally, any transactions between French QBU and German QBU occurring during the year of the merger will not result in transfers to or from a section 987 QBU. Pursuant to paragraph (f)(1) of this section, the combined QBU will have a net accumulated unrecognized section 987 gain from all prior taxable years of $10 (the $100 loss from French QBU plus the $110 gain from German QBU).

Example 2. *Separation of two section 987 QBUs that have the same owner*. (i) *Facts*. DC1, a domestic corporation, owns Entity A, a DE. Entity A conducts a business in the Netherlands that constitutes a section 987 QBU (Dutch QBU) that has the euro as its functional currency. The business of Dutch QBU consists of manufacturing and selling bicycles and scooters and is recorded on a single set of books and records. On the last day of Year 1, the adjusted basis of the gross assets of Dutch QBU is €1,000. In Year 2, the net accumulated unrecognized section 987 loss of Dutch QBU from all prior taxable years is $200. During Year 2, Entity A separates the bicycle and scooter business such that each business begins to have its own books and records and to meet the definition of a section 987 QBU under § 1.987–1(b)(2) (hereafter, "bicycle QBU" and "scooter QBU"). There are no transfers between DC1 and Dutch QBU before the separation. After the separation, the aggregate adjusted basis of bicycle QBU's assets is €600 and the aggregate adjusted basis of scooter QBU's assets is €400. Each section 987 QBU continues to have the euro as its functional currency.

(ii) *Analysis*. Pursuant to § 1.987–2T(c)(9)(iii), bicycle QBU and scooter QBU are separated QBUs, and the separation of Dutch QBU, a separating QBU, does not give rise to a transfer taken into account in determining the amount of a remittance (as defined in § 1.987–5(c)). For purposes of computing net unrecognized section 987 gain or loss under § 1.987–4 for Year 2, the separation will be deemed to have occurred on the last day of the owner's prior taxable year, Year 1. Pursuant to paragraph (f)(2) of this section, bicycle QBU will have a

net accumulated unrecognized section 987 loss of $120 (€600/€1,000 x $200), and scooter QBU will have a net accumulated unrecognized section 987 loss of $80 (€400/€1,000 x $200).

(g) [Reserved]. For further guidance, see § 1.987–4(g).

(h) *Effective/applicability date*. This section applies to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. Notwithstanding the preceding sentence, if a taxpayer makes an election under § 1.987–11(b), then this section applies to taxable years to which §§ 1.987–1 through 1.987–10 apply as a result of such election.

(i) *Expiration date*. The applicability of this section expires on December 6, 2019.

Par. 11. Section 1.987–6 is amended by adding paragraph (b)(4) to read as follows:

§ 1.987–6 Character and source of section 987 gain or loss.

* * * * *

(b) * * *

(4) [Reserved]. For further guidance, see § 1.987–6T(b)(4).

* * * * *

Par. 12. Section 1.987–6T is added to read as follows:

§ 1.987–6T Character and source of section 987 gain or loss (temporary)

(a)through (b)(3) [Reserved]. For further guidance, see § 1.987–6(a) through

(b)(3).

(4) *Source of section 987 gain or loss with respect to a dollar QBU*. The source of section 987 gain or loss with respect to a dollar QBU (as defined in § 1.987–1T(b)(6)(i)) for which the CFC owner has elected under § 1.987–1T(b)(6)(iii) to apply section 987 is determined by reference to the residence of the CFC owner. This paragraph (b)(4) applies to any CFC that has made the election under § 1.987–1T(b)(6)(iii), including a CFC described in § 1.987–1(b)(1)(ii).

(c) [Reserved]. For further guidance, see § 1.987–6(c).

(d) *Effective/applicability date*. This section applies to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. Notwithstanding the preceding sentence, if a taxpayer makes an election under § 1.987–11(b), then this section applies to taxable years to which §§ 1.987–1 through 1.987–10 apply as a result of such election.

(e) *Expiration date*. The applicability of this section expires on December 6, 2019.

Par. 13. Section 1.987–7 is amended by adding paragraph (b) to read as follows:

§ 1.987–7 Section 987 aggregate partnerships.

* * * * *

(b) [Reserved]. For further guidance, see § 1.987–7T(b).

* * * * *

Par. 14. Section 1.987–7T is added to read as follows:

§ 1.987–7T Section 987 aggregate partnerships (temporary).

(a) [Reserved]. For further guidance, see § 1.987–7(a).

(b) *Liquidation value percentage methodology*—(1) *In general*. In any taxable year, a partner's share of each asset, including its basis in each asset, and the amount of each liability reflected under § 1.987–2(b) on the books and records of an eligible QBU owned indirectly through a section 987 aggregate partnership is proportional to the partner's liquidation value percentage with respect to the aggregate partnership for that taxable year, as determined under paragraph (b)(2) of this section.

(2) *Liquidation value percentage*—(i) *In general*. For purposes of this paragraph (b), a partner's liquidation value percentage is the ratio (expressed as a percentage) of the liquidation value of the partner's interest in the partnership to the aggregate liquidation value of all of the partners' interests in the partnership. The liquidation value of a partner's interest in a partnership is the amount of cash the partner would receive with respect to the interest if, immediately following the applicable determination date, the partnership sold all of its assets for cash equal to the fair market value of such assets (taking into account section 7701(g)), satisfied all of its liabilities (other than those described in § 1.752–7), paid an unrelated third party to assume all of its § 1.752–7 liabilities in a fully taxable transaction, and then liquidated.

(ii) *Determination date*.—(A) *In general*. Except as provided in paragraph (b)(2)(ii)(B) of this section, the determination date is the date of the most recent event described in § 1.704–1(b)(2)(iv)(*f*)(*5*) or § 1.704–1(b)(2)(iv)(*s*)(*1*) (a revaluation event), irrespective of whether the capital accounts of the partners are adjusted under § 1.704–1(b)(2)(iv)(*f*), or, if there has been no revaluation event, the date of the formation of the partnership.

(B) *Allocations not in accordance with liquidation value percentage*. If a partnership agreement provides for the allocation of any item of income, gain, deduction, or loss from partnership property to a partner other than in accordance with the partner's liquidation value percentage, the determination date is the last day of the partner's taxable year, or, if the partner's section 987 QBU owned indirectly through a section 987 aggregate partnership terminates during the partner's taxable year, the date such section 987 QBU is terminated.

(3) *Example*. The following example illustrates the rule of this paragraph (b).

Example. (i) *Facts*. DC, a domestic corporation, owns all of the stock of FS, a controlled foreign corporation (as defined in section 957(a)) with the U.S. dollar as its functional currency. FS owns a capital and profits interest in FPRS, a

foreign partnership. The remaining capital and profits interest in FPRS is owned by DC. FPRS is a section 987 aggregate partnership with the euro as its functional currency. The balance sheet of FPRS reflects one asset (Asset A) with a basis of €60x and a fair market value of €100x, another asset (Asset B) with a basis of €100x and a fair market value of €200x, and a liability (Liability) of €50x. At the end of year 1, the liquidation value percentage, as determined under paragraph (b)(2) of this section, of DC with respect to FPRS is 75 percent, and the liquidation value percentage of FS with respect to FPRS is 25 percent.

(ii) *Result*. Under § 1.987–1(b)(4), DC and FS are each treated as indirectly owning an eligible QBU with a balance sheet that reflects their respective shares of any assets and liabilities of FPRS. Under paragraph (b)(1) of this section, DC and FS's shares of FPRS's assets and liabilities are determined in accordance with DC and FS's respective liquidation value percentages. Accordingly, because DC has a liquidation value percentage of 75 percent with respect to FPRS, €75x of Asset A (with a €45x basis), €150x of Asset B (with a €75x basis), and €37.50x of Liability will be attributed to the DC-FPRS QBU. Additionally, because FS has a liquidation value percentage of 25 percent with respect to FPRS, €25x of Asset A (with a €15x basis), €50x of Asset B (with a €25x basis), and €12.50x of Liability will be attributed to the FS-FPRS QBU.

(c) [Reserved]. For further guidance, see § 1.987–7(c).

(d) *Effective/applicability date*. This section applies to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. Notwithstanding the preceding sentence, if a taxpayer makes an election under § 1.987–11(b), then this section applies to taxable years to which §§ 1.987–1 through 1.987–10 apply as a result of such election.

(e) *Expiration date*. The applicability of this section expires on December 6, 2019.

Par. 15. Section 1.987–8 is amended by adding paragraph (d) to read as follows:

§ 1.987–8 Termination of a section 987 QBU.

* * * * *

(d) [Reserved]. For further guidance, see § 1.987–8T(d).

* * * * *

Par. 16. Section 1.987–8T is added to read as follows

§ 1.987–8T Termination of a section 987 QBU (temporary).

(a)through (c) [Reserved]. For further guidance, see § 1.987–8(a) through (c).

(d) *Annual deemed termination election*. A taxpayer, including a taxpayer described in § 1.987–1(b)(1)(ii) to which §§ 1.987–1 through 1.987–11 generally do not apply, may elect under this paragraph (d) to deem all of the section 987 QBUs of which it is an owner to terminate on the last day of each taxable year for which the election is in effect. See § 1.987–8(e) regarding the effect of such a

deemed termination. The owner of a section 987 QBU that is deemed to terminate under this paragraph is treated as having transferred all of the assets and liabilities attributable to such section 987 QBU to a new section 987 QBU on the first day of the following taxable year.

(e) through (f) [Reserved]. For further guidance, see § 1.987–8(e) through (f).

(g) *Effective/applicability date*. This section applies to taxable years beginning on or after December 7, 2016.

(h) *Expiration date*. The applicability of this section expires on December 6, 2019.

Par. 17. Section 1.987–12 is added to read as follows:

§ 1.987–12 Deferral of section 987 gain or loss.

(a) through (h) [Reserved]. For further guidance, see § 1.987–12T(a) through (h).

Par. 18. Section 1.987–12T is added to read as follows:

§ 1.987–12T Deferral of section 987 gain or loss (temporary).

(a) *In general*—(1) *Overview*. This section provides rules that defer the recognition of section 987 gain or loss that, but for this section, would be recognized in connection with certain QBU terminations and certain other transactions involving partnerships. This paragraph (a) provides an overview of this section and describes the section's scope of application, including with respect to QBUs subject to section 987 but to which §§ 1.987–1 through 1.987–11 generally do not apply. Paragraph (b) of this section describes the extent to which section 987 gain or loss is recognized under § 1.987–5 or similar principles in the taxable year of a deferral event (as defined in paragraph (b)(2) of this section) with respect to a QBU. Paragraph (c) of this section describes the extent to which section 987 gain or loss that, as a result of paragraph (b), is not recognized under § 1.987–5 or similar principles is recognized upon the occurrence of subsequent events. Paragraph (d) of this section describes the extent to which section 987 loss is recognized under § 1.987–5 or similar principles in the taxable year of an outbound loss event (as defined in paragraph (d)(2) of this section) with respect to a QBU. Paragraph (e) of this section provides rules for determining the source and character of gains and losses that, as a result of this section, are not recognized under § 1.987–5 or similar principles in the taxable year of a deferral event or outbound loss event. Paragraph (f) of this section defines controlled group and qualified successor for purposes of this section. Paragraph (g) of this section provides an anti-abuse rule. Paragraph (h) of this section provides examples illustrating the rules described in this section.

(2) *Scope*. This section applies to any foreign currency gain or loss realized under section 987(3), including foreign currency gain or loss of an entity described in § 1.987–1(b)(1)(ii). References in this section to section 987 gain or loss refer to any foreign currency gain or loss realized under section 987(3),

references to a section 987 QBU refer to any eligible QBU (as defined in § 1.987–1(b)(3)(i), but without regard to § 1.987–1(b)(3)(ii)) that is subject to section 987, and references to a section 987 aggregate partnership refer to any partnership for which the acquisition or disposition of a partnership interest could give rise to foreign currency gain or loss realized under section 987(3). Additionally, references to recognition of section 987 gain or loss under § 1.987–5 encompass any determination and recognition of gain or loss under section 987(3) that would occur but for this section. Accordingly, the principles of this section apply to a QBU subject to section 987 regardless of whether the QBU otherwise is subject to §§ 1.987–1 through 1.987–11. An owner of a QBU that is not subject to § 1.987–5 must adapt the rules set forth in this section as necessary to recognize section 987 gains or losses that are subject to this section consistent with the principles of this section.

(3) *Exceptions*—(i) *Annual deemed termination elections*. This section does not apply to section 987 gain or loss of a section 987 QBU with respect to which the annual deemed termination election described in § 1.987–8T(d) is in effect.

(ii) *De minimis exception*. This section does not apply to a section 987 QBU for a taxable year if the net unrecognized section 987 gain or loss of the section 987 QBU that, as a result of this section, would not be recognized under § 1.987–5 in the taxable year does not exceed $5 million.

(b) *Gain and loss recognition in connection with a deferral event*—(1) *In general*. Notwithstanding § 1.987–5, the owner of a section 987 QBU with respect to which a deferral event occurs (a deferral QBU) includes in taxable income section 987 gain or loss in connection with the deferral event only to the extent provided in paragraphs (b)(3) and (c) of this section. However, if the deferral event also constitutes an outbound loss event described in paragraph (d) of this section, the amount of loss recognized by the owner may be further limited under that paragraph.

(2) *Deferral event*—(i) *In general*. A deferral event with respect to a section 987 QBU means any transaction or series of transactions that satisfy the conditions described in paragraphs (b)(2)(ii) and (b)(2)(iii) of this section.

(ii) *Transactions*. The transaction or series of transactions include either:

(A) A termination of the section 987 QBU other than any of the following terminations: a termination described in § 1.987–8(b)(3), a termination described in § 1.987–8(c), or a termination described solely in § 1.987–8(b)(1); or

(B) A disposition of part of an interest in a section 987 aggregate partnership or DE through which the section 987 QBU is owned or any contribution by another person to such a partnership or DE of assets that, immediately after the contribution, are not considered to be included on the books and records of an eligible QBU, provided that the contribution gives rise to a deemed transfer from the section 987 QBU to the owner.

(iii) *Assets on books of successor QBU*. Immediately after the transaction or series of transactions, assets of the section 987 QBU are reflected on the books and records of a successor QBU (as defined in paragraph (b)(4) of this section).

(3) *Gain or loss recognized under § 1.987–5 in the taxable year of a deferral event*. In the taxable year of a deferral event with respect to a deferral QBU, the owner of the deferral QBU recognizes section 987 gain or loss as determined under § 1.987–5, except that, solely for purposes of applying § 1.987–5, all assets and liabilities of the deferral QBU that, immediately after the deferral event, are reflected on the books and records of a successor QBU are treated as not having been transferred and therefore as remaining on the books and records of the deferral QBU notwithstanding the deferral event.

(4) *Successor QBU*. For purposes of this section, a section 987 QBU (potential successor QBU) is a successor QBU with respect to a section 987 QBU referred to in paragraph (b)(2)(ii) of this section if, immediately after the transaction or series of transactions described in that paragraph, the potential successor QBU satisfies all of the conditions described in paragraphs (b)(4)(i) through (b)(4)(iii) of this section.

(i) The books and records of the potential successor QBU reflect assets that, immediately before the transaction or series of transactions described in paragraph (b)(2)(ii) of this section, were reflected on the books and records of the section 987 QBU referred to in that paragraph.

(ii) The owner of the potential successor QBU and the owner of the section 987 QBU referred to in paragraph (b)(2)(ii) of this section immediately before the transaction or series of transactions described in that paragraph are members of the same controlled group.

(iii) In the case of a section 987 QBU referred to in paragraph (b)(2)(ii)(A) of this section, if the owner of the section 987 QBU immediately before the transaction or series of transactions described in that paragraph was a U.S. person, the potential successor QBU is owned by a U.S. person.

(c) *Recognition of deferred section 987 gain or loss in the taxable year of a deferral event and in subsequent taxable years*—(1) *In general*—(i) *Deferred section 987 gain or loss*. A deferral QBU owner (as defined in paragraph (c)(1)(ii) of this section) recognizes section 987 gain or loss attributable to the deferral QBU that, as a result of paragraph (b) of this section, is not recognized in the taxable year of the deferral event under § 1.987–5 (deferred section 987 gain or loss) in the taxable year of the deferral event and in subsequent taxable years as provided in paragraphs (c)(2) through (4) of this section.

(ii) *Deferral QBU owner*. For purposes of this paragraph (c), a deferral QBU owner means, with respect to a deferral QBU, the owner of the deferral QBU immediately before the deferral event, or the owner's qualified successor.

(2) *Recognition upon a subsequent remittance*—(i) *In general*. Except as provided in paragraph (c)(3) of this section, a deferral QBU owner recognizes deferred section 987 gain or loss in the taxable year of the deferral event and in

subsequent taxable years upon a remittance from a successor QBU to the owner of the successor QBU (successor QBU owner) in the amount described in paragraph (c)(2)(ii) of this section.

(ii) *Amount*. The amount of deferred section 987 gain or loss that is recognized pursuant to this paragraph (c)(2) in a taxable year of the deferral QBU owner is the outstanding deferred section 987 gain or loss (that is, the amount of deferred section 987 gain or loss not previously recognized) multiplied by the remittance proportion of the successor QBU owner with respect to the successor QBU for the taxable year ending with or within the taxable year of the deferral QBU owner, as determined under § 1.987–5(b) (and, to the extent relevant, paragraphs (b) and (c)(2)(iii) of this section) without regard to any election under § 1.987–8T(d). For purposes of computing this remittance proportion, multiple successor QBUs of the same deferral QBU are treated as a single successor QBU.

(iii) *Deemed remittance when a successor QBU ceases to be owned by a member of the deferral QBU owner's controlled group*. For purposes of this paragraph (c)(2), in a taxable year of the deferral QBU owner in which a successor QBU ceases to be owned by a member of a controlled group that includes the deferral QBU owner, the successor QBU owner is treated as having a remittance proportion of 1. Accordingly, if there is only one successor QBU with respect to a deferral QBU and that successor QBU ceases to be owned by a member of the controlled group that includes the deferral QBU owner, all outstanding deferred section 987 gain or loss with respect to that deferral QBU will be recognized. This paragraph (c)(2)(iii) does not affect the application of §§ 1.987–1 through 1.987–11 to the successor QBU owner with respect to its ownership of the successor QBU.

(3) *Recognition of deferred section 987 loss in certain outbound successor QBU terminations*. Notwithstanding paragraph (c)(2) of this section, if assets of the successor QBU (transferred assets) are transferred (or deemed transferred) in a transaction that would constitute an outbound loss event if the successor QBU had a net accumulated section 987 loss at the time of the exchange, then the deferral QBU owner recognizes outstanding deferred section 987 loss, if any, to the extent it would recognize loss under paragraph (d)(1) of this section if (i) the deferral QBU owner owned the successor QBU, (ii) the deferral QBU owner had net unrecognized section 987 loss with respect to the successor QBU equal to its outstanding deferred section 987 loss with respect to the deferral QBU, and (iii) the transferred assets were transferred (or deemed transferred) in an outbound loss event. Any outstanding deferred section 987 loss with respect to the deferral QBU that is not recognized as a result of the preceding sentence is recognized by the deferral QBU owner in the first taxable year in which the deferral QBU owner (including any qualified successor) ceases to be a member of a controlled group that includes the acquirer of the transferred assets or any qualified successor of such acquirer.

(4) *Special rules regarding successor QBUs*—(i) *Successor QBU with respect to a deferral QBU that is a successor QBU*. If a section 987 QBU is a successor QBU with respect to a deferral QBU that is a successor QBU with respect to another deferral QBU, the first-mentioned section 987 QBU is considered a successor QBU with respect to the second-mentioned deferral QBU. For example, if QBU A is a successor QBU with respect to QBU B, and QBU B is a successor QBU with respect to QBU C, then QBU A is a successor QBU with respect to QBU C.

(ii) *Separation of a successor QBU*. If a successor QBU with respect to a deferral QBU separates into two or more separated QBUs (as defined in § 1.987–2T(c)(9)(iii)), each separated QBU is considered a successor QBU with respect to the deferral QBU.

(iii) *Combination of a successor QBU*. If a successor QBU with respect to a deferral QBU combines with another section 987 QBU of the same owner, resulting in a combined QBU (as defined in § 1.987–2T(c)(9)(i)), the combined QBU is considered a successor QBU with respect to the deferral QBU.

(d) *Loss recognition upon an outbound loss event*—(1) *In general*. Notwithstanding § 1.987–5, the owner of a section 987 QBU with respect to which an outbound loss event occurs (an outbound loss QBU) includes in taxable income in the taxable year of an outbound loss event section 987 loss with respect to that section 987 QBU only to the extent provided in paragraph (d)(3) of this section.

(2) *Outbound loss event*. An outbound loss event means, with respect to a section 987 QBU:

(i) Any termination of the section 987 QBU in connection with a transfer by a U.S. person of assets of the section 987 QBU to a foreign person that is a member of the same controlled group as the U.S. transferor immediately before the transaction or, if the transferee did not exist immediately before the transaction, immediately after the transaction (related foreign person), provided that the termination would result in the recognition of section 987 loss with respect to the section 987 QBU under § 1.987–5 and paragraph (b) of this section but for this paragraph (d);

(ii) Any transfer by a U.S. person of part of an interest in a section 987 aggregate partnership or DE through which the U.S. person owns the section 987 QBU to a related foreign person that has the same functional currency as the section 987 QBU, or any contribution by such a related foreign person to such a partnership or DE of assets that, immediately after the contribution, are not considered to be included on the books and records of an eligible QBU, provided that the transfer would result in the recognition of section 987 loss with respect to the section 987 QBU under § 1.987–5 and paragraph (b) of this section but for this paragraph (d).

(3) *Loss recognized upon an outbound loss event*. In the taxable year of an outbound loss event with respect to an outbound loss QBU, the owner of the outbound loss QBU recognizes section 987 loss as determined under § 1.987–5

and paragraphs (b) and (c) of this section, except that, solely for purposes of applying § 1.987–5, the following assets and liabilities of the outbound loss QBU are treated as not having been transferred and therefore as remaining on the books and records of the outbound loss QBU notwithstanding the outbound loss event:

(i) In the case of an outbound loss event described in paragraph (d)(2)(i) of this section, assets and liabilities that, immediately after the outbound loss event, are reflected on the books and records of the related foreign person described in that paragraph or of a section 987 QBU owned by such related foreign person; and

(ii) In the case of an outbound loss event described in paragraph (d)(2)(ii) of this section, assets and liabilities that, immediately after the outbound loss event, are reflected on the books and records of the eligible QBU from which the assets and liabilities of the outbound loss QBU are allocated and not on the books and records of a section 987 QBU.

(4) *Adjustment of basis of stock received in certain nonrecognition transactions*. If an outbound loss event results from the transfer of assets of the outbound loss QBU in a transaction described in section 351 or section 361, the basis of the stock that is received in the transaction is increased by an amount equal to the section 987 loss that, as a result of this paragraph (d), is not recognized with respect to the outbound loss QBU in the taxable year of the outbound loss event (outbound section 987 loss).

(5) *Recognition of outbound section 987 loss that is not converted into stock basis*. Outbound section 987 loss attributable to an outbound loss event that is not described in paragraph (d)(4) of this section is recognized by the owner of the outbound loss QBU in the first taxable year in which the owner or any qualified successor of the owner ceases to be a member of a controlled group that includes the related foreign person referred to in paragraph (d)(2)(i) or (ii) of this section, or any qualified successor of such person.

(e) *Source and character*—(1) *Deferred section 987 gain or loss and certain outbound section 987 loss*. The source and character of deferred section 987 gain or loss recognized pursuant to paragraph (c) of this section, and of outbound section 987 loss recognized pursuant to paragraph (d)(5) of this section, is determined under § 1.987–6 as if such deferred section 987 gain or loss were recognized pursuant to § 1.987–5 without regard to this section on the date of the related deferral event or outbound loss event.

(2) *Outbound section 987 loss reflected in stock basis*. If loss is recognized on the sale or exchange of stock described in paragraph (d)(4) of this section within two years of the outbound loss event described in that paragraph, then, to the extent of the outbound section 987 loss, the source and character of the loss recognized on the sale or exchange is determined under § 1.987–6 as if such loss were section 987 loss recognized pursuant to § 1.987–5 without regard to this section on the date of the outbound loss event.

(f) *Definitions*—(1) *Controlled group*. For purposes of this section, a controlled group means all persons with the relationships to each other specified in sections 267(b) or 707(b).

(2) *Qualified successor*. For purposes of this section, a qualified successor with respect to a corporation (transferor corporation) means another corporation (acquiring corporation) that acquires the assets of the transferor corporation in a transaction described in section 381(a), but only if (A) the acquiring corporation is a domestic corporation and the transferor corporation was a domestic corporation, or (B) the acquiring corporation is a controlled foreign corporation (as defined in section 957(a)) (CFC) and the transferor corporation was a CFC. A qualified successor of a corporation includes the qualified successor of a qualified successor of the corporation.

(g) *Anti-abuse*. No section 987 loss is recognized under § 1.987–5 or this section in connection with a transaction or series of transactions that are undertaken with a principal purpose of avoiding the purposes of this section.

(h) *Examples*. The following examples illustrate the application of this section. For purposes of the examples, DC1 is a domestic corporation that owns all of the stock of DC2, which is also a domestic corporation, and CFC1 and CFC2 are CFCs. In addition, DC1, DC2, CFC1, and CFC2 are members of a controlled group as defined in paragraph (f)(1) of this section, and the de minimis rule of paragraph (a)(3)(ii) of this section is not applicable. Finally, except as otherwise provided, Business A is a section 987 QBU with the euro as its functional currency, there are no transfers between Business A and its owner, and Business A's assets are not depreciable or amortizable.

Example 1. *Contribution of a section 987 QBU to a member of the controlled group*. (i) *Facts*. DC1 owns all of the interests in Business A. The balance sheet of Business A reflects assets with an aggregate adjusted basis of €1,000x and no liabilities. DC1 contributes €900x of Business A's assets to DC2 in an exchange to which section 351 applies. Immediately after the contribution, the remaining €100x of Business A's assets are no longer reflected on the books and records of a section 987 QBU. DC2, which has the U.S. dollar as its functional currency, uses the former Business A assets in a business (Business B) that constitutes a section 987 QBU. At the time of the contribution, Business A has net accumulated unrecognized section 987 gain of $100x.

(ii) *Analysis*. (A) Under § 1.987–2(c)(2)(ii), DC1's contribution of €900x of Business A's assets to DC2 is treated as a transfer of all of the assets of Business A to DC1, immediately followed by DC1's contribution of €900x of Business A's assets to DC2. The contribution of Business A's assets is a deferral event within the meaning of paragraph (b)(2) of this section because: (1) the transfer from Business A to DC1 is a transfer of substantially all of Business A's assets to DC1, resulting in a termination of Business A under § 1.987–8(b)(2); and (2) immediately after the transaction, assets of Business A are reflected on the books and records of Business B, a section 987 QBU owned by a member of DC1's controlled group and a successor QBU within the meaning of paragraph

(b)(4) of this section. Accordingly, Business A is a deferral QBU within the meaning of paragraph (b)(1) of this section, and DC1 is a deferral QBU owner of Business A within the meaning of paragraph (c)(1)(ii) of this section.

(B) Under paragraph (b)(3) of this section, DC1's taxable income in the taxable year of the deferral event includes DC1's section 987 gain or loss determined with respect to Business A under § 1.987–5, except that, for purposes of applying § 1.987–5, all assets and liabilities of Business A that are reflected on the books and records of Business B immediately after Business A's termination are treated as not having been transferred and therefore as though they remained on Business A's books and records (notwithstanding the deemed transfer of those assets under § 1.987–8(e)). Accordingly, in the taxable year of the deferral event, DC1 is treated as making a remittance of €100x, corresponding to the assets of Business A that are no longer reflected on the books and records of a section 987 QBU, and is treated as having a remittance proportion with respect to Business A of 0.1, determined by dividing the €100x remittance by the sum of the remittance and the €900x aggregate adjusted basis of the gross assets deemed to remain on Business A's books at the end of the year. Thus, DC1 recognizes $10x of section 987 gain in the taxable year of the deferral event. DC1's deferred section 987 gain equals $90x, which is the amount of section 987 gain that, but for the application of paragraph (b) of this section, DC1 would have recognized under § 1.987–5 ($100x), less the amount of section 987 gain recognized by DC1 under § 1.987–5 and this section ($10x).

Example 2. *Election to be classified as a corporation*. (i) *Facts*. DC1 owns all of the interests in Entity A, a DE. Entity A conducts Business A, which has net accumulated unrecognized section 987 gain of $500x. Entity A elects to be classified as a corporation under § 301.7701–3(a). As a result of the election and pursuant to § 301.7701–3(g)(1)(iv), DC1 is treated as contributing all of the assets and liabilities of Business A to newly-formed CFC1, which has the euro as its functional currency. Immediately after the contribution, the assets and liabilities of Business A are reflected on CFC1's balance sheet.

(ii) *Analysis*. Under § 1.987–2(c)(2)(ii), DC1's contribution of all of the assets and liabilities of Business A to CFC1 is treated as a transfer of all of the assets and liabilities of Business A to DC1, followed immediately by DC1's contribution of those assets and liabilities to CFC1. Because the deemed transfer from Business A to DC1 is a transfer of substantially all of Business A's assets to DC1, the Business A QBU terminates under § 1.987–8(b)(2). The contribution of Business A's assets is not a deferral event within the meaning of paragraph (b)(2) of this section because, immediately after the transaction, no assets of Business A are reflected on the books and records of a successor QBU within the meaning of paragraph (b)(4) of this section due to the fact that the assets of Business A are not reflected on a section 987 QBU immediately after the termination as well as the fact that the requirement of paragraph (b)(4)(iii) of this section is not met. Accordingly, DC1 recognizes section 987 gain with respect to Business A under § 1.987–5 without regard to this section. Because the requirement of paragraph

(b)(4)(iii) of this section is not met, the result would be the same even if the assets of Business A were transferred in a section 351 exchange to an existing foreign corporation that had a different functional currency than Business A.

Example 3. *Outbound loss event*. (i) *Facts*. The facts are the same as in *Example 2*, except that Business A has net accumulated unrecognized section 987 loss of $500x rather than net accumulated unrecognized section 987 gain of $500x.

(ii) *Analysis*. (A) The analysis of the transactions under §§ 1.987–2(c)(2)(ii), 1.987–8(b)(2), and paragraph (b) of this section is the same as in *Example 2*. However, the termination of Business A as a result of the transfer of the assets of Business A by a U.S. person (DC1) to a foreign person (CFC1) that is a member of DC1's controlled group is an outbound loss event described in paragraph (d)(2) of this section.

(B) Under paragraphs (d)(1) and (d)(3) of this section, in the taxable year of the outbound loss event, DC1 includes in taxable income section 987 loss recognized with respect to Business A as determined under § 1.987–5, except that, for purposes of applying § 1.987–5, all assets and liabilities of Business A that are reflected on the books and records of CFC1, a related foreign person described in paragraph (d)(2) of this section, are treated as not having been transferred. Accordingly, DC1's remittance proportion with respect to Business A is 0, and DC1 recognizes no section 987 loss with respect to Business A. DC1's outbound section 987 loss is $500x, which is the amount of section 987 loss that DC1 would have recognized under § 1.987–5 ($500x) without regard to paragraph (d) of this section, less the amount of section 987 loss recognized by DC1 under paragraph (d)(3) of this section ($0). Under paragraph (d)(4) of this section, DC1 must increase its basis in its CFC1 shares by the amount of the outbound section 987 loss ($500x).

Example 4. *Conversion of a DE to a partnership*. (i) *Facts*. DC1 owns all of the interests in Entity A, a DE that conducts Business A. On the last day of Year 1, DC1 sells 50 percent of its interest in Entity A to DC2 (the Entity A sale).

(ii) *Analysis*. (A) For Federal income tax purposes, Entity A is converted to a partnership when DC2 purchases the 50 percent interest in Entity A. DC2's purchase is treated as the purchase of 50 percent of the assets of Entity A (that is, the assets of Business A), which, prior to the purchase, were treated as held directly by DC1 for Federal income tax purposes. Immediately after DC2's deemed purchase of 50 percent of Business A assets, DC1 and DC2 are treated as contributing their respective interests in Business A assets to a partnership. See Rev. Rul. 99–5 (1999–1 CB 434) (situation 1). These deemed transactions are not taken into account for purposes of this section, but the Entity A sale and resulting existence of a partnership have consequences under section 987 and this section, as described in paragraphs (ii)(B) through (D) of this *Example 4*.

(B) Immediately after the Entity A sale, Entity A is a section 987 aggregate partnership within the meaning of § 1.987–1(b)(5) because DC1 and DC2 own all the interests in partnership capital and profits, DC1 and DC2 are related within the meaning of section 267(b), and the partnership has an eligible QBU

(Business A) that would be a section 987 QBU with respect to a partner if owned by the partner directly. As a result of the Entity A sale, 50 percent of the assets and liabilities of Business A ceased to be reflected on the books and records of DC1's Business A section 987 QBU. As a result, such assets and liabilities are treated as if they were transferred from DC1's Business A section 987 QBU to DC1. Additionally, following DC2's acquisition of 50 percent of the interest in Entity A, DC2 is allocated 50 percent of the assets and liabilities of Business A under §§ 1.987–2(b), 1.987–7(a), and 1.987–7T(b). Because DC2 and Business A have different functional currencies, DC2's portion of the Business A assets and liabilities constitutes a section 987 QBU. Accordingly, 50 percent of the assets and liabilities of Business A are treated as transferred by DC2 to DC2's Business A section 987 QBU.

(C) The Entity A sale is a deferral event described in paragraph (b)(2) of this section because: (1) the sale constitutes the disposition of part of an interest in a DE; and (2) immediately after the transaction, assets of DC1's Business A section 987 QBU are reflected on the books and records of DC1's Business A section 987 QBU and DC2's Business A section 987 QBU, each of which is a successor QBU with respect to DC1's Business A section 987 QBU within the meaning of paragraph (b)(4) of this section. Accordingly, DC1's Business A section 987 QBU is a deferral QBU within the meaning of paragraph (b)(1) of this section, and DC1 is a deferral QBU owner within the meaning of paragraph (c)(1)(ii) of this section. Under paragraph (b)(1) of this section, DC1 includes in taxable income section 987 gain or loss with respect to Business A in connection with the deferral event to the extent provided in paragraphs (b)(3) and (c) of this section.

(D) Under paragraph (b) of this section, in the taxable year of the Entity A sale, DC1 includes in taxable income section 987 gain or loss with respect to Business A as determined under § 1.987–5, except that, for purposes of applying § 1.987–5, all assets and liabilities of Business A that, immediately after the Entity A sale, are reflected on the books and records of successor QBUs are treated as though they were not transferred and therefore as remaining on the books and records of DC1's Business A section 987 QBU notwithstanding the Entity A sale. Accordingly, DC1's remittance amount under § 1.987–5 is $0, and DC1 recognizes no section 987 gain or loss with respect to Business A.

Example 5. *Partial recognition of deferred gain or loss*. (i) *Facts*. DC1 owns all of the interests in Entity A, a DE that conducts Business A in Country X. During Year 1, DC1 contributes all of its interests in Entity A to DC2 in an exchange to which section 351 applies. At the time of the contribution, Business A has net accumulated unrecognized section 987 gain of $100x. After the contribution, Entity A continues to conduct business in Country X (Business B). In Year 3, as a result of a net transfer of property from Business B to DC2, DC2's remittance proportion with respect to Business B, as determined under § 1.987–5, is 0.25.

(ii) *Analysis*. (A) For the reasons described in *Example 1*, the contribution of Entity A by DC1 to DC2 results in a termination of Business A and a deferral event with respect to Business A, a deferral QBU; DC1 is a deferral QBU owner

within the meaning of paragraph (c)(1)(ii) of this section; Business B is a successor QBU with respect to Business A; DC2 is a successor QBU owner; and the $100x of net accumulated unrecognized section 987 gain with respect to Business A becomes deferred section 987 gain as a result of the deferral event.

(B) Under paragraph (c)(1) of this section, DC1 recognizes deferred section 987 gain with respect to Business A in accordance with paragraphs (c)(2) through (4) of this section. Under paragraph (c)(2)(i) of this section, DC1 recognizes deferred section 987 gain in Year 3 as a result of the remittance from Business B to DC2. Under paragraph (c)(2)(ii) of this section, the amount of deferred section 987 gain that DC1 recognizes is $25x, which is DC1's outstanding deferred section 987 gain or loss ($100x) with respect to Business A multiplied by the remittance proportion (0.25) of DC2 with respect to Business B for the taxable year as determined under § 1.987–5(b).

(i) *Coordination with fresh start transition method*—(1) *In general*. If a taxpayer is a deferral QBU owner, or is or was the owner of an outbound loss QBU, and the taxpayer is required under § 1.987–10(a) to apply the fresh start transition method described in § 1.987–10(b) to the deferral QBU or outbound loss QBU, or would have been so required if the taxpayer had owned the deferral QBU or outbound loss QBU on the transition date (as defined in § 1.987–11(c)), the adjustments described in paragraphs (i)(2) and (i)(3) of this section, as applicable, must be made on the transition date.

(2) *Adjustment to deferred section 987 gain or loss*. The amount of any outstanding deferred section 987 gain or loss of a deferral QBU owner with respect to a deferral QBU described in paragraph (i)(1) of this section must be adjusted to equal the amount of outstanding deferred section 987 gain or loss that the deferral QBU owner would have had with respect to the deferral QBU on the transition date if, immediately before the deferral event, the deferral QBU had transitioned to the method prescribed by §§ 1.987–1 through 1.987–10 pursuant to the fresh start transition method.

(3) *Adjustments in the case of an outbound loss event*. The basis of any stock described in paragraph (d)(4) of this section that was received in connection with the transfer (or deemed transfer) of assets of an outbound loss QBU described in paragraph (i)(1) of this section and that is held on the transition date must be adjusted to equal the basis that such stock would have had on the transition date if, immediately prior to the outbound loss event, the outbound loss QBU had transitioned to the method prescribed by §§ 1.987–1 through 1.987–10 pursuant to the fresh start transition method. If no such stock was received, the amount of any outbound section 987 loss with respect to the outbound loss QBU that may be recognized on or after the transition date pursuant to paragraph (d)(5) of this section must be adjusted to equal the amount of such loss that would be outstanding and that may be recognized pursuant to that paragraph if, immediately before the outbound loss event, the outbound loss QBU had transitioned to the method prescribed by §§ 1.987–1 through 1.987–10 pursuant to the fresh start transition method.

(j) *Effective/applicability date*—(1) *In general*. Except as described in paragraph (j)(2) of this section, this section applies to any deferral event or outbound loss event that occurs on or after January 6, 2017.

(2) *Exception*. This section applies to any deferral event or outbound loss event that occurs on or after December 7, 2016, if such deferral event or outbound loss event is undertaken with a principal purpose of recognizing section 987 loss.

(k) *Expiration date*. The applicability of this section expires December 6, 2019.

Par. 19. Section 1.988–0 is amended by revising the entry for § 1.988–2(b)(16) and adding an entry for § 1.988–2(i) to read as follows:

§ 1.988–0. Taxation of gain or loss from a section 988 transaction; Table of contents.

* * * * *

§ 1.988–2 Recognition and computation of exchange gain or loss.

* * * * *

(b) * * *

(16) [Reserved].

* * * * *

(i) [Reserved].

Par. 20. Section 1.988–1 is amended by adding paragraph (a)(3) to read as follows:

§ 1.988–1 Certain definitions and special rules.

* * * * *

(a) * * *

(3) [Reserved]. For further guidance, see § 1.988–1T(a)(3).

* * * * *

Par. 21. Section 1.988–1T is added to read as follows:

§ 1.988–1T Certain definitions and special rules (temporary).

(a)(1) through (a)(2) [Reserved]. For further guidance, see § 1.988–1(a)(1) through (2).

(3) *Specified owner functional currency transactions of a section 987 QBU not treated as section 988 transactions*. Specified owner functional currency transactions, as defined in § 1.987–3T(b)(4)(ii), held by a section 987 QBU are not treated as section 988 transactions. Thus, no currency gain or loss shall be recognized by a section 987 QBU under section 988 with respect to such transactions.

(4) through (i) [Reserved]. For further guidance, see § 1.988–1(a)(4) through (i).

(j) *Effective/applicability date*. This section applies to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. Notwithstanding the preceding sentence, if a taxpayer makes an election under § 1.987–11(b), then this section applies to taxable years to which §§ 1.987–1 through 1.987–10 apply as a result of such election.

(k) *Expiration date*. The applicability of this section expires on December 6, 2019.

Par. 22. Section 1.988–2 is amended by revising paragraph (b)(16) and adding paragraph (i) to read as follows:

§ 1.988–2 Recognition and computation of exchange gain or loss.

* * * * *

(b) * * *

(16) [Reserved]. For further guidance, see § 1.988–2T(b)(16).

* * * * *

(i) [Reserved]. For further guidance, see § 1.988–2T(i).

Par. 23. Section 1.988–2T is added to read as follows:

§ 1.988–2T Recognition and computation of exchange gain or loss (temporary).

(a) through (b)(15) [Reserved]. For further guidance, see § 1.988–2(a) through (b)(15).

(16) *Deferral of loss on certain related-party debt instruments*.—(i) *Treatment of creditor*. For rules applicable to a corporation included in a controlled group that is a creditor under a debt instrument see § 1.267(f)–1(e).

(ii) *Treatment of debtor*—(A) *In general*. Exchange loss realized under § 1.988–2(b)(4) or (b)(6) is deferred if—

(*1*) The loss is realized by a debtor with respect to a loan from a person that has a relationship to the debtor described in section 267(b) or section 707(b); and

(*2*) The transaction resulting in the realization of exchange loss has as a principal purpose the avoidance of Federal income tax.

(B) *Recognition of deferred loss*. Any exchange loss that is deferred under paragraph (b)(16)(ii)(A) of this section is deferred until the end of the term of the loan, determined immediately prior to the transaction.

(17) through (h) [Reserved]. For further guidance, see § 1.988–2(b)(17) through (h).

(i) *Special rules for section 988 transactions of a section 987 QBU*. For rules regarding section 988 transactions of a section 987 QBU, see § 1.987–3T(b)(4) for section 987 QBUs in general and § 1.987–1T(b)(6) for dollar QBUs.

(j) *Effective/applicability date*. Paragraph (b)(16) of this section applies to any exchange loss realized on or after December 7, 2016. Paragraph (i) of this section applies to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. Notwithstanding the preceding sentence, if a taxpayer makes an election under § 1.987–11(b), then paragraph (i) of this section applies to taxable years to which §§ 1.987–1 through 1.987–10 apply as a result of such election.

(k) *Expiration date*. The applicability of this section expires on December 6, 2019.

John Dalrymple, *Deputy Commissioner for Services and Enforcement.*

Approved November 14, 2016,

Mark J. Mazur,*Assistant Secretary of the Treasury (Tax Policy).*

Note

(Filed by the Office of the Federal Register on December 7, 2016, 8:45 a.m., and published in the issue of the Federal Register for December 8, 2016, 81 F.R. 88854)

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[11] The transfer of a section 987 QBU as part of a liquidation or asset reorganization described in section 381(a) in which the transferor and transferee have the same tax status is not a termination under § 1.987–8(b) and (c) and, therefore, cannot constitute a deferral event under the first category.

TD 9801

Issue Price Definition for Tax-Exempt Bonds

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

AGENCY:

Internal Revenue Service (IRS), Treasury.

ACTION:

Final regulations.

SUMMARY:

This document contains final regulations on the definition of issue price for purposes of the arbitrage investment restrictions that apply to tax-exempt bonds and other tax-advantaged bonds. These final regulations affect State and local governments that issue tax-exempt bonds and other tax-advantaged bonds.

DATES:

Effective date: These regulations are effective on December 9, 2016.

Applicability date: For the date of applicability, see § 1.148–11(m).

FOR FURTHER INFORMATION CONTACT:

Lewis Bell at (202) 317-6980 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-1347. The collection of information in these final regulations is in § 1.148–1(f)(2)(ii), which requires the underwriter to provide to the issuer a certification and reasonable supporting documentation for use of the initial offering price to the public, § 1.148–1(f)(2)(iii), which requires the issuer to obtain a certification from the underwriter for competitive sales, and § 1.148–1(f)(2)(iv), which requires the issuer to identify in its books and records the rule used to determine the issue price of the bonds. The respondents are issuers of tax-exempt bonds that want to apply the special rules in § 1.148–1(f)(2) to determine the issue price of the bonds.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by section 6103.

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) on the arbitrage investment restrictions under section 148 of the Internal Revenue Code (Code). On June 18, 1993, the Department of the Treasury (Treasury Department) and the IRS published comprehensive final regulations in the **Federal Register** (TD 8476, 58 FR 33510) on the arbitrage investment restrictions and related provisions for tax-exempt bonds under sections 103, 148, 149, and 150. Since that time, those final regulations have been amended in various limited respects, including most recently in final regulations

published in the **Federal Register** (TD 9777, 81 FR 46582) on July 18, 2016 (the regulations issued in 1993 and the various amendments thereto are collectively referred to as the Existing Regulations).

A notice of proposed rulemaking was published in the **Federal Register** (78 FR 56842; REG–148659–07) on September 16, 2013 (the 2013 Proposed Regulations), which, among other things, proposed to amend the definition of "issue price." Subsequently, the Treasury Department and the IRS withdrew § 1.148–1(f) of the 2013 Proposed Regulations regarding the definition of issue price and published another notice of proposed rulemaking in the **Federal Register** (80 FR 36301; REG–138526–14) on June 24, 2015, which re-proposed a definition of issue price (the 2015 Proposed Regulations). Comments were received and a public hearing was held on October 28, 2015. After consideration of all of the public comments, the Treasury Department and the IRS adopt the 2015 Proposed Regulations, with revisions, by this Treasury decision (the Final Regulations).

Summary of Comments and Explanation of Provisions

This section discusses the comments received from the public regarding the 2015 Proposed Regulations. The comments are available for public inspection at *www.regulations.gov*. This section also explains revisions made in the Final Regulations.

1. *Introduction*.

Under section 103, interest received by investors on eligible State and local bonds is exempt from Federal income tax. As a result, tax-exempt bonds tend to have lower interest rates than taxable obligations. Section 148 generally limits investment of proceeds of tax-exempt bonds to investment yields that are not materially higher than the yield on the bond issue. Section 148 also generally requires that excess investment earnings be paid to the Federal Government at periodic intervals. For purposes of these arbitrage investment restrictions, section 148(h) provides that yield on an issue is to be determined on the basis of the issue price (within the meaning of sections 1273 and 1274). The reason for using issue price (rather than sales proceeds less the costs of issuance) to determine yield for purposes of section 148(h) is to ensure that issuers bear the costs of issuance, rather than recover these costs through arbitrage profits. See H. Rep. No. 99–426, at 517 (1985). The report of the Committee on Ways and Means states that the Committee believed that this requirement would encourage issuers to scrutinize costs of issuance more closely and would encourage better targeting of the federal subsidy associated with tax-exempt bonds. Id., at 517–518. In general, the lower the issue price for bonds bearing a stated interest rate, the higher the yield. An issuer has an economic incentive to receive the highest price for bonds and to pay the lowest yield. This aligns with the purpose of the arbitrage restrictions, which is to minimize arbitrage investment benefits and remove incentives to issue more tax-exempt bonds, and thus to limit the federal revenue cost of the tax subsidy for tax-exempt bonds.

The issue price definition under the Existing Regulations generally follows the issue price definition used for computing original issue discount on debt instruments under sections 1273 and 1274, with certain modifications. The definition of issue price under the Existing Regulations provides generally that the issue price of bonds that are publicly offered is the first price at which a substantial amount of the bonds is sold to the public. The Existing Regulations define a substantial amount to mean ten percent. Further, the Existing Regulations include a special rule that applies a reasonable expectations standard (rather than a standard based on actual sales) to determine, as of the sale date,[12] the issue price for bonds for which a bona fide public offering is made, based on reasonable expectations regarding the initial offering price. The issue prices of bonds with different payment and credit terms are determined separately. Tax-exempt bond issues often include bonds with different payment and credit terms that generally sell at different prices.

The special rule in the Existing Regulations that provides for the determination of issue price as of the sale date based on reasonable expectations about the initial public offering price aims, in part, to provide certainty that the bonds will qualify as tax-exempt bonds and meet State or local requirements for debt issuance. Generally, the sale date is the date when the syndicate or sole underwriter in contractual privity with the issuer signs the agreement to buy the bonds from the issuer and when the terms of the bond issue are set. In the municipal bond market, due largely to the serial maturity structure and, in many cases, an inability to sell a substantial amount of each of the different maturities of the bonds with different terms (for which issue price must be determined separately) by the sale date, issuers may have difficulties in establishing the issue price of all of the bonds included within an issue by the sale date, unless a special rule is available.

2. *General Rule: Actual Sale of a Substantial Amount of Bonds*.

Consistent with section 148(h), the 2015 Proposed Regulations proposed to retain the rule that issue price generally will be determined under the rules of sections 1273 and 1274. The 2015 Proposed Regulations also proposed a general rule similar to that in the regulations under section 1273 that the issue price of bonds issued for money is the first price at which a substantial amount of the bonds is sold to the public. The 2015 Proposed Regulations proposed to retain the rule in the Existing Regulations that ten percent is the measure of a substantial amount. The 2015 Proposed Regulations also proposed to retain the rule that the issue prices of bonds with different payment and credit terms are determined separately.

Commenters recommended adding an express rule to address the treatment of private placements (for example, bank loans), which in the municipal bond industry typically do not involve underwriters. Commenters also recommended clarifying that an issuer may use the general rule to determine issue price even

if the issuer had sought to use the special rule based on the initial offering price to the public discussed in section 3 of this preamble. The Treasury Department and the IRS agree with these recommendations.

The Final Regulations retain the rules in the Existing Regulations and the general rule of the 2015 Proposed Regulations that, for bonds issued for money, the issue price is the first price at which a substantial amount of the bonds is sold to the public, and a substantial amount is ten percent. In addition, in response to comments, the Final Regulations expressly provide that, for a bond issued for money in a private placement to a single buyer that is not an underwriter or a related party (as defined in § 1.150–1(b)) to an underwriter, the issue price of the bond is the price paid by that buyer. Further, the Final Regulations clarify that for bonds for which more than one rule for determining issue price is available, for example, the general rule and one of the special rules discussed in sections 3 and 4 of this preamble, an issuer may select the rule it will use to determine the issue price for the bonds at any time on or before the issue date of the bonds. On or before the issue date of the bonds, the issuer must identify the rule selected in its books and records maintained for the bonds.

A commenter suggested that a specific time on the sale date should be established as the proper time for determining issue price. The Treasury Department and the IRS understand that it has been a longstanding practice to determine issue price on the sale date without regard to a specific time and that it is unlikely for bonds to be sold to the public at different prices on that date. Thus, the imposition of a specific time deadline for such determination seems unnecessary and would add to the administrative burden. The Final Regulations do not adopt this comment.

3. *Special Rule for Use of the Initial Offering Price to the Public*.

The 2015 Proposed Regulations proposed a special rule that would allow an issuer to treat the initial offering price to the public as the issue price as of the sale date, provided certain requirements were met. That proposed special rule (referred to as the “alternative method” in the 2015 Proposed Regulations) proposed to require that the lead underwriter (or sole underwriter, if applicable) certify certain matters, including that no underwriter would sell bonds after the sale date and before the issue date at a price higher than the initial offering price except if the higher price was the result of a market change for the bonds after the sale date (for example, due to a change in market interest rates), and that the lead underwriter provide the issuer with supporting documentation for the matters covered by the certifications, including a justification for any higher price based on a market change. (This proposed requirement for underwriters generally to hold the price at no higher than the initial offering price to the public until the issue date is sometimes referred to herein as the “hold-the-offering-price” requirement.)

Commenters favored a special rule to allow use of the initial offering price to the public to set the issue price as of the sale date. Numerous commenters, however, expressed concerns about various aspects of the eligibility requirements for this proposed special rule. One concern expressed by underwriters was that the requirement for the lead underwriter to provide certification as to the actions of the entire underwriting syndicate or selling group was overly broad. Instead, underwriters recommended allowing members of an underwriting syndicate or a selling group to agree individually to act in accordance with the specific matters required under the special rule. The Final Regulations adopt the comment that each underwriter is individually or severally responsible for its agreement (rather than jointly responsible with other underwriters).

Several commenters suggested that the hold-the-offering-price requirement would result in lower offering prices and should not be included in the special rule. One concern expressed related to the differing time periods between the sale date and the issue date for various issuers. One commenter recommended limiting the time period for holding the price to six business days after the sale date. Further, notwithstanding the potential flexibility in pricing afforded by the proposed market change exception to the hold-the-offering-price requirement, commenters overwhelmingly objected to this exception as unworkable because of the absence of meaningful benchmarks for municipal bond prices. Commenters also expressed concern that use of this exception could lead to audit disputes over appropriate documentation to support such price changes.

Accordingly, the Final Regulations adopt a modified hold-the-offering-price requirement that requires underwriters to hold the price for offering and selling unsold bonds at a price that is no greater than the initial offering price to the public for a shorter time period that ends on the earlier of (1) the close of the date that is the fifth (5th) business day after the sale date or (2) the date on which the underwriters have sold a substantial amount of the bonds to the public. Further, in response to the overwhelming negative comments about the proposed market change exception to the proposed hold-the-offering-price requirement, the Final Regulations omit the market change exception.

The modified hold-the-offering-price requirement in the Final Regulations provides a standardized time period for application of the requirement to bonds regardless of the differing time periods among issuers between sales and closings of municipal bond issues. Further, the shorter time period for this requirement should reduce potential associated risks to underwriters and thereby limit the effects of this requirement on initial pricing to issuers and, at the same time, ensure that market pricing behavior is consistent with the initial offering price used for issue price determinations.

Two commenters suggested confirming that, for purposes of the hold-the-offering-price requirement, an underwriter may sell bonds to anyone at a price that is lower (rather than higher) than the initial offering price to the public under this special rule. This special rule expressly provides for this result under the Final Regulations. One commenter sought clarification that underwriters

may sell bonds to other underwriters at prices that are higher than the initial offering price to the public under this special rule. Sales to underwriters at such higher prices are inconsistent with a purpose of this special rule to use the initial offering price to the public as a proxy for the issuer's agreement with the underwriters about the maximum amount of underwriters' compensation that is reflected in setting the issue price. Thus, the Final Regulations clarify that underwriters may not sell the bonds at a price that is higher than the initial offering price to the public.

Several commenters recommended a different special rule that would base determinations of issue price on sales of an aggregate percentage of all of the bonds included within an issue, as distinguished from the bond-by-bond method required to determine issue price for bonds with different interest rates, maturities, credits, or payment terms under the Existing Regulations and the 2015 Proposed Regulations. Commenters recommended different percentages of sales of aggregate principal amounts of bonds within an issue to determine issue price, including 25 percent, 50 percent, and 65 percent.

Although a rule that would focus on actual sales of greater percentages of the aggregate principal amounts of bonds included within an issue to determine issue price has potential utility, the Treasury Department and the IRS have concerns about the comparability of the terms of unsold bonds with the terms of sold bonds, which would serve as a proxy for setting the issue price of the unsold bonds, and about the attendant potential complexity to ensure appropriate comparability. Further, the Treasury Department and the IRS have concerns about selection of an appropriate percentage of aggregate sales for such a rule and whether issuers would be able to sell the required percentage of the aggregate principal amount of bonds within the issue. The public comments did not reflect any consensus on an appropriate percentage of aggregate sales for such a rule. In addition, several of the comments in favor of such a rule focused particularly on the need for a more workable rule for competitive sales. In response to this concern, the Final Regulations provide a simplified special rule for competitive sales, as described in section 4 of this preamble. Accordingly, the Final Regulations do not adopt a rule that would focus on actual sales of greater percentages of the aggregate principal amounts of bonds included within an issue.

In summary, the Final Regulations provide a special rule under which an issuer may treat the initial offering price to the public as the issue price of the bonds as of the sale date if: (1) The underwriters offered the bonds to the public at a specified initial offering price on or before the sale date, and the lead underwriter in the underwriting syndicate or selling group (or, if applicable, the sole underwriter) provides, on or before the issue date, a certification to that effect to the issuer, together with reasonable supporting documentation for that certification, such as a copy of the pricing wire or equivalent communication; and (2) each underwriter agrees in writing that it will neither offer nor sell the bonds to any person at a price that is higher than the initial offering price during the period starting on the sale date and ending on the

earlier of the close of the fifth (5th) business day after the sale date, or the date on which the underwriters have sold a substantial amount of the bonds to the public at a price that is no higher than the initial offering price to the public.

4. *Special Rule for Competitive Sales*.

Numerous commenters, including four States, strongly urged a streamlined special rule for competitive sales to allow the reasonably expected initial offering price to the public reflected in the winning bid in a competitive sale to establish the issue price without a hold-the-offering-price requirement or other restrictions. Commenters suggested that the public bidding process for pricing municipal bonds in competitive sales itself provides a sufficient basis to achieve the best pricing for issuers. The Treasury Department and the IRS recognize that competitive sales favor competition and price transparency that may result in better pricing for issuers. The Final Regulations adopt these comments and provide that, for bonds issued for money pursuant to an eligible competitive sale, an issuer may treat the reasonably expected initial offering price to the public of the bonds as the issue price of the bonds as of the sale date if the issuer obtains a certification from the winning bidder regarding the reasonably expected initial offering price to the public of the bonds upon which the price in the winning bid is based.

For purposes of this special rule, the Final Regulations define *competitive sale* to mean a sale of bonds by an issuer to an underwriter that is the winning bidder in a bidding process in which the issuer offers the bonds for sale to underwriters at specified written terms and that meets the following requirements: (1) The issuer disseminates the notice of sale to potential underwriters in a manner reasonably designed to reach potential underwriters; (2) all bidders have an equal opportunity to bid; (3) the issuer receives bids from at least three underwriters of municipal bonds who have established industry reputations for underwriting new issuances of municipal bonds; and (4) the issuer awards the sale to the bidder who offers the highest price (or lowest interest cost).

5. *Definitions*.

The 2015 Proposed Regulations proposed to define the term “public” for purposes of determining the issue price of tax-exempt bonds to mean any person other than an underwriter or a related party to an underwriter. Several commenters recommended expanding the definition of public to include related parties to underwriters. This recommended change would allow various affiliates of underwriters, such as entities involved in proprietary trading, to qualify as members of the public for purposes of determining issue price. The Final Regulations do not adopt this comment. The Final Regulations retain this related party restriction on the definition of the public as a safeguard to protect against potential abuse.

The 2015 Proposed Regulations proposed to define “underwriter” to include: (1) Any person that contractually agrees to participate in the initial sale of the bonds to the public by entering into a contract with the issuer or into a contract

with a lead underwriter to form an underwriting syndicate and (2) any person that, on or before the sale date, directly or indirectly enters into a contract or other arrangement with any of the foregoing to sell the bonds. Numerous commenters expressed significant concern that the phrase “other arrangement” in the definition of underwriter was vague and unworkable. One commenter asked if distribution arrangements (for example, a retail distribution contract between a member of an underwriting syndicate or selling group and another dealer that is not in the syndicate or selling group) were included. Another commenter suggested changes to clarify that a contract to sell the bonds be limited to a contract with respect to the initial sale of the bonds to the public. In response to these comments, the Final Regulations omit the phrase “or other arrangement” from the definition of underwriter. The Final Regulations also clarify that covered agreements must relate to the initial sale of the bonds to the public and that these agreements include retail distribution agreements.

6. *Standard for Reliance on Certifications and Consequences of Violations*.

The 2015 Proposed Regulations proposed a standard that would limit an issuer’s ability to rely on certifications from underwriters to circumstances in which an issuer did not know or have reason to know, after exercising due diligence, that the certifications were false. Several commenters expressed concerns about this proposed standard for reliance on certifications. One commenter expressed particular concern that the proposed standard appeared to be higher than or different from the general due diligence standard for determining reasonable expectations that bonds are not arbitrage bonds under § 1.148–2(b) of the Existing Regulations. The existing definition of reasonable expectations, found in § 1.148–1(b) of the Existing Regulations, treats an issuer’s expectations or actions as reasonable only if a prudent person in the same circumstances as the issuer would have those same expectations or take those same actions, based on all the objective facts and circumstances. One commenter also sought confirmation that issuers could rely on certifications from underwriters without independent verification.

In response to the comments, the Final Regulations omit the proposed special standard for reliance on underwriters’ certifications. Instead, the existing due diligence standard under the Existing Regulations for reasonable expectations or reasonableness will apply to any certification under the Final Regulations. For example, this existing due diligence standard will apply under the special rule on competitive sales to an issuer’s reliance on a certification from the winning bidder regarding the reasonably expected initial offering price to the public of the bonds upon which the price in the winning bid is based.

Several commenters urged providing conclusive legal certainty for issue price determinations as of the sale date based on receipt of required underwriter certifications without regard to whether such certifications subsequently proved to be false. Although the Final Regulations generally will allow issuers to establish the issue price as of the sale date, the Final Regulations do not adopt this comment. Accordingly, a failure to meet a specific eligibility requirement of

a rule for determining issue price, such as an underwriter's breach of its hold-the-offering-price agreement under the special rule for use of initial offering price, will result in a failure to establish issue price under that rule and a redetermination of issue price under a different rule. The potential invalidation of an issue price determination is important to ensure compliance with the arbitrage restrictions and the legal availability of penalties against underwriters for false statements. A false statement by an underwriter in a certification or in the agreement among underwriters under one of these special rules may result in a penalty against the underwriter under section 6700, depending on the facts and circumstances.

In accordance with section 6001, the issuer must maintain reasonable documentation in its books and records to support its issue price determinations. In addition, the Final Regulations require that the issuer obtain from the underwriter certain certifications and other reasonable supporting documentation such as a pricing wire to establish its issue price determination under a specific rule in the Final Regulations. A certification from the underwriter of the first price at which ten percent of the bonds were sold to the public is an example of reasonable supporting documentation to establish the issue price of the bonds under the general rule in the Final Regulations.

7. *Other Comments*

A commenter requested a special rule under section 148 to determine issue price in a debt-for-debt exchange, including an exchange resulting from a significant modification under § 1.1001–3. Under the special rule, an issuer would have the option to use a tax-exempt bond's stated principal amount as the issue price rather than the issue price that otherwise would apply under section 1273 or 1274. The commenter requested the rule because, in the commenter's experience, the stated interest rate on a tax-exempt bond issued in a debt-for-debt exchange was generally less than the adjusted applicable Federal rate (AAFR) used under section 1288 to determine whether the bond has adequate stated interest for purposes of section 1274. In this situation, the issue price of the bond would be less than the bond's stated principal amount, resulting in an arbitrage yield that is higher than it otherwise would be if the bond were treated as issued for an amount equal to the bond's stated principal amount. The Final Regulations do not include such a rule because, since the date of the commenter's request, the method to determine the AAFR has been modified in TD 9763, 81 FR 24482 (April 26, 2016). As a result of this modification, it is more likely that the issue price of a tax-exempt bond issued in a debt-for-debt exchange will be the bond's stated principal amount under section 1273 or 1274 (for example, because the AAFR will not be greater than the corresponding applicable Federal rate for taxable bonds, as it was in certain years before the modification).

In addition, some commenters recommended allowing the use of issue price as defined for arbitrage purposes in applying various limitations for other tax-exempt bond purposes, such as those based on principal amounts, face

amounts, and sale proceeds. The Final Regulations do not adopt this recommendation because it raises issues that are beyond the scope of the 2015 Proposed Regulations, and the recommended extension of the application of the definition of issue price beyond arbitrage purposes appropriately warrants a separate opportunity for public comment. The Treasury Department and the IRS, however, expect to consider this recommendation in connection with future guidance.

Applicability Date

The Final Regulations apply to bonds that are sold on or after June 7, 2017.

Special Analyses

Certain IRS regulations, including these Final Regulations, are exempt from the requirements of Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory impact assessment is not required.

It is hereby certified that these Final Regulations will not have a significant economic impact on a substantial number of small entities. This certification is based generally on the fact that any effect on small entities by these rules generally flows from section 148 of the Code. Section 148(h) of the Code requires the yield on an issue of bonds to be determined on the basis of issue price (within the meaning of sections 1273 and 1274). Under section 1273(b), the issue price is the first price at which a substantial amount of the bonds is sold to the public. Section 1.148–1(f)(2) of the Final Regulations gives effect to the statute by requiring the issuer to (1) obtain certain documentation from the underwriter, which is the party that sells the bonds to the public, to support the issuer's determination of issue price and (2) indicate in its books and records the rule used by the issuer to determine issue price. This information will be used to support the issue price of the bonds for audit and other purposes. Any economic impact of obtaining this information is minimal because most of the information already is provided to issuers by the underwriters under existing industry practices. Accordingly, these changes do not add to the impact on small entities imposed by the statutory provision. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Pursuant to section 7805(f) of the Code, the 2015 Proposed Regulations preceding these Final Regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

Drafting Information

The principal authors of these regulations are Johanna Som de Cerff and Lewis Bell, Office of Associate Chief Counsel (Financial Institutions and Products), IRS. However, other personnel from the Treasury Department and the IRS participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.148–0(c) is amended by adding entries for §§ 1.148–1(f) and 1.148–11(m) to read as follows:

***§ 1.148–0 Scope and table of contents*.**

* * * * *

(c) * * *

***§ 1.148–1 Definitions and elections*.**

* * * * *

(f) Definition of issue price.

(1) In general.

(2) Bonds issued for money.

(3) Definitions.

(4) Other special rules.

* * * * *

***§ 1.148–11 Effective/applicability dates*.**

* * * * *

(m) Definition of issue price.

Par. 3. Section 1.148–1 is amended by revising the definition of issue price in paragraph (b) and adding paragraph (f) to read as follows:

***§ 1.148–1 Definitions and elections*.**

* * * * *

(b) * * *

Issue price means issue price as defined in paragraph (f) of this section.

* * * * *

(f) *Definition of issue price*—(1) *In general*. Except as otherwise provided in this paragraph (f), "issue price" is defined in sections 1273 and 1274 and the regulations under those sections.

(2) *Bonds issued for money*—(i) *General rule*. Except as otherwise provided in this paragraph (f)(2), the issue price of bonds issued for money is the first price at which a substantial amount of the bonds is sold to the public. If a bond is issued for money in a private placement to a single buyer that is not an underwriter or a related party (as defined in § 1.150–1(b)) to an underwriter, the issue price of the bond is the price paid by that buyer. Issue price is not reduced by any issuance costs (as defined in § 1.150–1(b)).

(ii) *Special rule for use of initial offering price to the public*. The issuer may treat the initial offering price to the public as of the sale date as the issue price of the bonds if the requirements of paragraphs (f)(2)(ii)(A) and (B) of this section are met.

(A) The underwriters offered the bonds to the public for purchase at a specified initial offering price on or before the sale date, and the lead underwriter in the underwriting syndicate or selling group (or, if applicable, the sole underwriter) provides, on or before the issue date, a certification to that effect to the issuer, together with reasonable supporting documentation for that certification, such as a copy of the pricing wire or equivalent communication.

(B) Each underwriter agrees in writing that it will neither offer nor sell the bonds to any person at a price that is higher than the initial offering price to the public during the period starting on the sale date and ending on the earlier of the following:

(*1*) The close of the fifth (5th) business day after the sale date; or

(*2*) The date on which the underwriters have sold a substantial amount of the bonds to the public at a price that is no higher than the initial offering price to the public.

(iii) *Special rule for competitive sales*. For bonds issued for money in a competitive sale, an issuer may treat the reasonably expected initial offering price to the public as of the sale date as the issue price of the bonds if the issuer obtains from the winning bidder a certification of the bonds' reasonably expected initial offering price to the public as of the sale date upon which the price in the winning bid is based.

(iv) *Choice of rule for determining issue price*. If more than one rule for determining the issue price of the bonds is available under this paragraph (f)(2), at any time on or before the issue date, the issuer may select the rule it will use to determine the issue price of the bonds. On or before the issue date of the bonds, the issuer must identify the rule selected in its books and records maintained for the bonds.

(3) *Definitions*. For purposes of this paragraph (f), the following definitions apply:

(i) *Competitive sale* means a sale of bonds by an issuer to an underwriter that is the winning bidder in a bidding process in which the issuer offers the bonds for sale to underwriters at specified written terms, if that process meets the following requirements:

(A) The issuer disseminates the notice of sale to potential underwriters in a manner that is reasonably designed to reach potential underwriters (for example, through electronic communication that is widely circulated to potential underwriters by a recognized publisher of municipal bond offering documents or by posting on an Internet-based Web site or other electronic medium that is regularly used for such purpose and is widely available to potential underwriters);

(B) All bidders have an equal opportunity to bid (within the meaning of § 1.148–5(d)(6)(iii)(A)(*6*));

(C) The issuer receives bids from at least three underwriters of municipal bonds who have established industry reputations for underwriting new issuances of municipal bonds; and

(D) The issuer awards the sale to the bidder who submits a firm offer to purchase the bonds at the highest price (or lowest interest cost).

(ii) *Public* means any person (as defined in section 7701(a)(1)) other than an underwriter or a related party (as defined in § 1.150–1(b)) to an underwriter.

(iii) *Underwriter* means:

(A) Any person (as defined in section 7701(a)(1)) that agrees pursuant to a written contract with the issuer (or with the lead underwriter to form an underwriting syndicate) to participate in the initial sale of the bonds to the public; and

(B) Any person that agrees pursuant to a written contract directly or indirectly with a person described in paragraph (f)(3)(iii)(A) of this section to participate in the initial sale of the bonds to the public (for example, a retail distribution agreement between a national lead underwriter and a regional firm under which the regional firm participates in the initial sale of the bonds to the public).

(4) *Other special rules*. For purposes of this paragraph (f), the following special rules apply:

(i) *Separate determinations*. The issue price of bonds in an issue that do not have the same credit and payment terms is determined separately. The issuer need not apply the same rule to determine issue price for all of the bonds in the issue.

(ii) *Substantial amount*. Ten percent is a substantial amount.

(iii) *Bonds issued for property*. If a bond is issued for property, the adjusted applicable Federal rate, as determined under section 1288 and § 1.1288–1, is used in lieu of the applicable Federal rate to determine the bond's issue price

under section 1274.

Par. 4. Section 1.148–11 is amended by adding paragraph (m) to read as follows:

§ 1.148–11 Effective/applicability dates.

* * * * *

(m) *Definition of issue price*. The definition of issue price in § 1.148–1(b) and (f) applies to bonds that are sold on or after June 7, 2017.

John Dalrymple, *Deputy Commissioner for Services and Enforcement.*

Approved November 22, 2016,

Mark J. Mazur, *Assistant Secretary of the Treasury for Tax Policy.*

Note

(Filed by the Office of the Federal Register on December 8, 2016, 8:45 a.m., and published in the issue of the Federal Register for December 9, 2016, 81 F.R. 88999)

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[12] Under § 1.150–1(c)(6), the sale date of a bond is the first day on which there is a binding contract in writing for the sale or exchange of the bond. By comparison, under § 1.150–1(b), the issue date for a bond is the date on which the issuer receives the purchase price in exchange for that bond, commonly referred to as the closing date or settlement date.

TD 9802

Disclosures of Return Information Reflected on Returns to Officers and Employees of the Department of Commerce for Certain Statistical Purposes and Related Activities

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

AGENCY:

Internal Revenue Service (IRS), Treasury.

ACTION:

Temporary regulations.

SUMMARY:

This document contains temporary regulations that authorize the disclosure of certain items of return information to the Bureau of the Census (Bureau) in conformance with section 6103(j)(1) of the Internal Revenue Code (Code). These temporary regulations are made pursuant to a request from the Secretary of Commerce. These temporary regulations also provide clarifying language for an item of return information and remove duplicative paragraphs contained in the existing regulations. These temporary regulations require no action by taxpayers and have no effect on their tax liabilities. Thus, no taxpayers are likely to be affected by the disclosures authorized by this guidance. The text of the temporary regulations also serves as the text of the proposed regulations set forth in the Proposed Rules section in this issue of the **Bulletin.**

DATES:

Effective Date: These temporary regulations are effective on December 9, 2016.

Applicability Date: For dates of applicability, see § 301.6103(j)(1)–1T(e).

FOR FURTHER INFORMATION CONTACT:

William Rowe, (202) 317-6834 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document contains amendments to 26 CFR part 301. Section 6103(j)(1)(A) of the Internal Revenue Code authorizes the Secretary of the Treasury (Secretary) to furnish, upon written request by the Secretary of Commerce, such returns or return information as the Secretary may prescribe by regulation to officers and employees of the Bureau for the purpose of, but only to the extent necessary in, the structuring of censuses and national economic accounts and conducting related statistical activities authorized by law. Section 301.6103(j)(1)–1 of the existing regulations further defines such purposes by reference to 13 U.S.C. chapter 5 and provides an itemized description of the return information authorized to be disclosed for such purposes.

By letter dated August 2, 2016, the Secretary of Commerce requested amendments to § 301.6103(j)(1)–1 to allow disclosure of several additional items of return information to the Bureau for purposes of its economic statistics program, structuring the censuses, and related program evaluations. The Secretary of Commerce's letter lists the additional items of return information requested based on the Bureau's specific need for each item of information.

The Secretary of Commerce's letter requested additional expense items from business tax returns in order to improve the expense data that is collected by the Bureau. Specifically, the Secretary of Commerce requested disclosure of the following enumerated components of total expenses or total deductions from business tax returns (Forms 1065, Forms in the 1120 series, and Form 1040, Schedule C, E or C/EZ): (1) repairs (and maintenance) expense; (2) rents (or lease) expense; (3) taxes and licenses expense; (4) interest expense, including

mortgage or other interest; (5) depreciation expense; (6) depletion expense; (7) advertising expense; (8) pension and profit-sharing plans (retirement plans) expense; (9) employee benefit programs expense; (10) utilities expense; (11) supplies expense; (12) contract labor expense; and (13) management (and investment advisory) fees. The Secretary of Commerce has also requested purchases from Form 1125–A and the following additional items from Form 1040, Schedule C: (1) materials and supplies; and (2) purchases less cost of items withdrawn for personal use. The Secretary of Commerce determined that these additional items are needed to evaluate the quality of expense data collected from surveys and to improve the Bureau's imputation models as the Bureau faces a trend of rising non-response rates in its surveys.

The Secretary of Commerce's letter also requested additional items of return information from business tax returns for the purpose of directing a high proportion of research and development surveys towards businesses with known research activities. Specifically, the Secretary of Commerce requested the following additional items of return information from Forms 6765 (when filed with corporation income tax returns): (1) cycle posted; and (2) the research tax credit amount to be carried over to a business return, schedule, or form. The Secretary of Commerce determined that the amount of research tax credit is needed to improve the coverage and reliability of surveys that collect research and development data, and determined that the cycle posted is needed in order to align the research tax credit with the appropriate survey year for sampling purposes.

The Secretary of Commerce's letter also requested additional items of return information for purposes of maintaining a centralized, continuous Business Register that comprehensively lists and characterizes United States business establishments and their domestic parent enterprises. The Business Register provides the central business list necessary to support the Bureau's economic census and survey activities. Specifically, the Secretary of Commerce requested the following additional items of return information from employment tax returns: (1) if a business has closed or stopped paying wages; (2) final date a business paid wages; and (3) if a business is a seasonal employer and does not have to file a return for every quarter of the year. The Secretary of Commerce has determined that these items of return information are vital to reducing or eliminating costly mailings to businesses that have closed or are seasonal in nature. The Secretary of Commerce also requested the electronic system filing indicator from business tax returns and the cycle from the IRS's Business Master Files. The Secretary of Commerce determined that the electronic system filing indicator is needed to help establish the ideal survey mode for a particular entity (electronic or paper reporting forms).

The Secretary of Commerce's letter also requested additional items of return information for purposes of modeling firm survival for production of statistics on business dynamics. Specifically, the Secretary of Commerce has requested the following additional items of return information from business tax returns: (1) dividends, including ordinary and qualified; and (2) type of REIT (from Form

1120–REIT). The Secretary of Commerce has determined that these items are needed to estimate models of firm survival and to estimate an owner's percentage of capital.

The Secretary of Commerce's letter also requested additional items of return information for purposes of the Survey of Business Owners. Specifically, the Secretary of Commerce has requested the following additional items of return information from Form 1065, Schedule K–1: (1) publicly-traded partnership indicator; (2) partner's share of nonrecourse, qualified nonrecourse, and recourse liabilities; and (3) ordinary business income (loss). The Secretary of Commerce has also requested ordinary business income (loss) from Forms 1120S, Schedule K–1. The Secretary of Commerce has determined that the ordinary business income (loss) and partner's share of liabilities items are needed in order to ascertain which owner's demographic information to use for the entity and as a proxy for ownership share of the partner. The publicly-traded partnership indicator is needed to save the cost of mailing surveys to publicly-traded partnerships since it is unlikely that publicly-traded partnerships could accurately provide demographic information about their owners.

Finally, the Secretary of Commerce's letter also requested additional items of return information for purposes of developing and preparing the Quarterly Financial Report. Specifically, the Secretary of Commerce requested the following additional items of return information from Forms 1120–REIT: (1) type of Real Estate Investment Trust ("REIT"); and (2) gross rents from real property. The Secretary of Commerce also requested the corporation's method of accounting from Form 1120F and the total amount reported from Form 1096. The Secretary of Commerce determined that gross rents from real property is needed to design and select the annual Quarterly Financial Report sample, and that the type of REIT is needed for editing and imputation purposes in the event that there are characteristic differences between the types of REITs. The Secretary of Commerce determined that the corporation's method of accounting is needed to understand how businesses with different accounting methods might report differently in the Quarterly Financial Report surveys. The Secretary of Commerce has determined that the total amounts reported from Form 1096 are needed to measure labor inputs for productivity since it would provide information on labor costs not covered by administrative records or survey reports of payroll.

The Secretary of Commerce asserted that good cause exists to amend § 301.6103(j)(1)–1 of the regulations to add these additional items to the list of items of return information that may be disclosed to the Bureau. The Treasury Department and the IRS agree that amending existing regulations to permit disclosure of these items to the Bureau is appropriate to meet the needs of the Bureau. These temporary regulations amend the existing regulations to allow disclosure of the items requested by the Secretary of Commerce.

This temporary regulation also amends language in the existing regulations to clarify that the T.D. 9500, which was published in the **Federal Register** (75 F.R. 52458), authorized disclosure only of categorical information for total qualified

research expenses from Forms 6765. In accordance with the preamble to T.D. 9500, the existing regulations do not authorize the disclosure of the exact amount of total research expenses as reported on Form 6765. By letter dated February 6, 2006, the Secretary of Commerce requested disclosure of categorical information on total qualified research expenses in three ranges: greater than zero, but less than $1 million; greater than or equal to $1 million, but less than $3 million; and, greater than or equal to $3 million. These temporary regulations amend the existing regulations to more clearly reflect the categorical nature of the disclosure of total research expenses from Form 6765.

Lastly, this temporary regulation also removes duplicate paragraphs contained in the existing regulations. Under the existing regulations, each of the following items of return information from business-related returns was authorized for disclosure by two identical paragraphs: Social Security tip income; total Social Security taxable earnings; and gross distributions from employer-sponsored and individual retirement plans from Form 1099–R. Because there is no need for duplicate paragraphs that authorize disclosure of the same items of return information for the same purpose, the duplicate paragraphs are removed.

The text of the temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Bulletin.**

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities because the regulations do not impose a collection of information on small entities. Accordingly, a regulatory flexibility analysis is not required under the Regulatory Flexibility Act (5 U.S.C. chapter 6). Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of these temporary regulations is William Rowe, Office of the Associate Chief Counsel (Procedure & Administration).

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—-PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 301.6103(j)(1)–1T is added to read as follows:

§ 301.6103(j)(1)–1T Disclosures of return information reflected on returns to officers and employees of the Department of Commerce, for certain statistical purposes and related activities (Temporary).

(a) through (b)(2)(iii)(H) [Reserved]. For further guidance see § 301.6103(j)(1)–1(a) through (b)(2)(iii)(H).

(I) Total taxable wages paid for purposes of chapter 21;

(J) [Reserved]. For further guidance see § 301.6103(j)(1)–1(b)(2)(iii)(J).

(K) If a business has closed or stopped paying wages;

(L) Final date a business paid wages; and

(M) If a business is a seasonal employer and does not have to file a return for every quarter of the year;

(b)(2)(iv) through (b)(3)(iv) [Reserved]. For further guidance see § 301.6103(j)(1)–1(b)(2)(iv) through (b)(3)(iv).

(v) Total expenses or deductions, including totals of the following components thereof:

(A) Repairs (and maintenance) expense;

(B) Rents (or lease) expense;

(C) Taxes and licenses expense;

(D) Interest expense, including mortgage or other interest;

(E) Depreciation expense;

(F) Depletion expense;

(G) Advertising expense;

(H) Pension and profit-sharing plans (retirement plans) expense;

(I) Employee benefit programs expense;

(J) Utilities expense;

(K) Supplies expense;

(L) Contract labor expense; and

(M) Management (and investment advisory) fees.

(b)(3)(vi) through (b)(3)(xxiv) [Reserved]. For further guidance see § 301.6103(j)(1)–1(b)(3)(vi) through (b)(3)(xxiv).

(xxv) From Form 6765 (when filed with corporation income tax returns)—

(A) Indicator that total qualified research expenses is greater than zero, but less than $1 million; greater than or equal to $1 million, but less than $3 million; or, greater than or equal to $3 million;

(B) Cycle posted; and

(C) Research tax credit amount to be carried over to a business return, schedule, or form.

(xxvi) Total number of documents reported on Form 1096 transmitting Forms 1099–MISC.

(xxvii) Total amount reported on Form 1096 transmitting Forms 1099–MISC.

(xxviii) Type of REIT.

(xxix) From Form 1125–A—purchases.

(xxx) From Form 1040, Schedule C—

(A) Purchases less cost of items withdrawn for personal use; and

(B) Materials and supplies.

(xxxi) Electronic filing system indicator.

(xxxii) Posting cycle date relative to filing.

(xxxiii) Dividends, including ordinary or qualified.

(xxxiv) From Form 1120S, Schedule K–1—ordinary business income (loss).

(xxxv) From Form 1065, Schedule K–1—

(A) Publicly-traded partnership indicator;

(B) Partner's share of nonrecourse, qualified nonrecourse, and recourse liabilities; and

(C) Ordinary business income (loss).

(b)(4) through (b)(6)(i)(B) [Reserved]. For further guidance see § 301.6103(j)(1)–1(b)(4) through (b)(6)(i)(B).

(C) From Form 1120–REIT—

(*1*) Type of REIT; and

(*2*) Gross rents from real property;

(D) From Form 1120F—corporation's method of accounting.

(E) From Form 1096—total amount reported.

(b)(6)(ii) through (d)(3)(ii) [Reserved]. For further guidance see § 301.6103(j)(1)–1(b)(6)(ii) through (d)(3)(ii).

(e) *Applicability date*. This section applies to disclosures to the Bureau of the Census made on or after December 9, 2016.

(f) *Expiration date*. The applicability of this section expires on or before December 9, 2019.

John Dalrymple, *Deputy Commissioner for Services and Enforcement.*

Approved November 23, 2016.

Mark J. Mazur, *Assistant Secretary of the Treasury (Tax Policy).*

Note

(Filed by the Office of the Federal Register on December 8, 2016, 8:45 a.m., and published in the issue of the Federal Register for December 9, 2016, 81 F.R. 89004)

Rev. Rul. 2017–02

This revenue ruling provides various prescribed rates for federal income tax purposes for January 2017 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(1) for buildings placed in service during the current month. However, under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%. Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Finally, Table 6 contains the deemed rate of return for transfers made during calendar year 2017 to pooled income funds described in section 642(c)(5) that have been in existence for less than 3 taxable years immediately preceding the taxable year in which the transfer was made.

REV. RUL. 2017–02 TABLE 1				
Applicable Federal Rates (AFR) for January 2017				
Period for Compounding				
	Annual	***Semiannual***	***Quarterly***	***Monthly***
		Short-term		
AFR	.96%	.96%	.96%	.96%

REV. RUL. 2017–02 TABLE 1

Applicable Federal Rates (AFR) for January 2017

Period for Compounding

	Annual	***Semiannual***	***Quarterly***	***Monthly***
110% AFR	1.06%	1.06%	1.06%	1.06%
120% AFR	1.15%	1.15%	1.15%	1.15%
130% AFR	1.25%	1.25%	1.25%	1.25%
		Mid-term		
AFR	1.97%	1.96%	1.96%	1.95%
110% AFR	2.17%	2.16%	2.15%	2.15%
120% AFR	2.36%	2.35%	2.34%	2.34%
130% AFR	2.57%	2.55%	2.54%	2.54%
150% AFR	2.96%	2.94%	2.93%	2.92%
175% AFR	3.46%	3.43%	3.42%	3.41%
		Long-term		
AFR	2.75%	2.73%	2.72%	2.71%
110% AFR	3.02%	3.00%	2.99%	2.98%
120% AFR	3.31%	3.28%	3.27%	3.26%
130% AFR	3.58%	3.55%	3.53%	3.52%

REV. RUL. 2017–02 TABLE 2

Adjusted AFR for January 2017

Period for Compounding

	Annual				***Semiannual***	***Quarterly***	***Monthly***
Short-term adjusted AFR	.71%	.71%	.71%	.71%			

REV. RUL. 2017–02 TABLE 2							
Adjusted AFR for January 2017							
Period for Compounding							
	Annual				***Semiannual***	***Quarterly***	***Monthly***
Mid-term adjusted AFR	1.47%	1.46%	1.46%	1.46%			
Long-term adjusted AFR	2.04%	2.03%	2.02%	2.02%			

REV. RUL. 2017–02 TABLE 3	
Rates Under Section 382 for January 2017	
Adjusted federal long-term rate for the current month	2.04%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	2.04%

REV. RUL. 2017–02 TABLE 4	
Appropriate Percentages Under Section 42(b)(1) for January 2017	
Note: Under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%.	
Appropriate percentage for the 70% present value low-income housing credit	7.54%
Appropriate percentage for the 30% present value low-income housing credit	3.23%

REV. RUL. 2017–02 TABLE 5	
Rate Under Section 7520 for January 2017	
Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	2.4%

REV. RUL. 2017–02 TABLE 6	
Deemed Rate for Transfers to New Pooled Income Funds During 2017	
Deemed rate of return for transfers during 2017 to pooled income funds that have been in existence for less than 3 taxable years	1.2%

Part III. Administrative, Procedural, and Miscellaneous

Notice 2017–01

Eligibility for Exemption from User Fee Requirement for Employee Plans Determination Letter Applications Filed On or After January 1, 2017

I. Purpose

Section 7528(b)(2)(B) of the Internal Revenue Code provides an exemption from the requirement to pay a user fee for certain requests to the Internal Revenue Service (IRS) for determination letters with respect to the qualified status of pension, profit-sharing, stock bonus, annuity, and employee stock ownership (ESOP) plans maintained by small employers. Under § 7528(b)(2)(B), the exemption from the user fee does not apply to any request made after the later of (i) the fifth plan year of the plan's existence or (ii) the end of any remedial amendment period with respect to the plan beginning within the first five plan years (a "qualifying open remedial amendment period"). Section 7528(b)(2)(A) also permits the Secretary of the Treasury to provide exemptions from the user fee requirement. This notice describes the circumstances under which, in light of changes to the remedial amendment period rules set forth in Rev. Proc. 2016–37, 2016–29 I.R.B. 136, the IRS will treat an application for a determination letter as being filed within a qualifying open remedial amendment period (one of the requirements for the user fee exemption). Specifically, this notice provides that the IRS will treat an application for a determination letter as being filed within a qualifying open remedial amendment period if the plan was first in existence no earlier than January 1 of the tenth calendar year preceding the year in which the application is filed ("the ten-year rule").

This notice also provides that an application that satisfies the requirements for the user fee exemption in § 7528(b)(2)(B), but that does not meet the requirements for the ten-year rule described in the preceding paragraph, may be filed without a user fee. However, the application must include a statement describing how the application satisfies the exemption under § 7528(b)(2)(B).

II. Background

Section 7528(a)(1) provides the general rule that the Secretary of the Treasury is to establish a program requiring the payment of user fees for requests to the IRS for determination letters. The IRS user fee program procedures for requests involving employee plans and exempt organizations are published as part of the annual revenue procedures issued by the IRS. See, for example, Rev. Proc. 2016–8, 2016–1 I.R.B. 243.

Section 7528(b)(2)(A) provides that the Secretary shall provide for such exemptions from the user fee requirement (and reduced fees) as the Secretary determines to be appropriate.

Section 7528(b)(2)(B) provides that, in general, a request for a determination letter with respect to the qualified status of a pension benefit plan or any trust that is part of the plan shall be exempt from the user fee requirement if the plan is maintained solely by one or more eligible employers. Under § 7528(b)(2)(C)(i), a pension benefit plan means a pension, profit-sharing, stock bonus, annuity, or ESOP plan. Under § 7528(b)(2)(C)(ii), an eligible employer means an employer that has no more than 100 employees who received at least $5,000 of compensation from the employer for the preceding year, and that has at least one employee who is not a highly compensated employee (as defined in § 414(q)) and is participating in the plan. However, the § 7528(b)(2)(B) user fee exemption does not apply if the request is made after the later of (1) the last day of the fifth plan year the plan is in existence, or (2) the end of any qualifying open remedial amendment period. The § 7528(b)(2)(B) user fee exemption also does not apply to any request made by the sponsor of any prototype or similar plan that the sponsor intends to market to participating employers.

Rev. Proc. 2007–44, 2007–2 C.B. 54, provides for a system of cyclical remedial amendment periods and staggered submission periods for determination letter applications for individually designed plans and pre-approved plans. Under Rev. Proc. 2007–44, the remedial amendment cycle for individually designed plans is five years and the remedial amendment cycle for pre-approved plans is six years.

Rev. Proc. 2016–37 eliminates the remedial amendment cycle system for individually designed plans set forth in Rev. Proc. 2007–44, as of January 1, 2017. The revenue procedure provides that sponsors of Cycle A plans may continue to file under the remedial amendment cycle system until January 31, 2017. In addition, the revenue procedure makes clarifying changes to the ongoing six-year remedial amendment cycle system for pre-approved qualified plans. It also provides that the deadline for certain employers to adopt a newly approved pre-approved defined contribution plan that was based on the 2010 Cumulative List, and to apply for a determination letter, is extended from April 30, 2016, to April 30, 2017, for any newly approved pre-approved defined contribution plan adopted on or after January 1, 2016.

Notice 2002–1, 2002–1 C.B. 283, as amplified by Notice 2003–49, 2003–2 C.B. 294, provides guidance with respect to the requirements for the § 7528(b)(2)(B) user fee exemption, including an explanation of when a plan is “in existence” for

that purpose (see Q&A–4 of Notice 2002–1). In addition, Notice 2011–86, 2011–45 I.R.B. 698, amplifies Notice 2002–1 by providing rules for determining, under the remedial amendment cycle system, if an application for a determination letter has been filed within a qualifying open remedial amendment period.

III. Applications Treated as Being Filed Within a Qualifying Open Remedial Amendment Period

An application for a determination letter with respect to a pension, profit-sharing, stock bonus, annuity, or ESOP plan maintained by an eligible employer that is filed with the IRS by the later of (1) the last day of the fifth plan year the plan is in existence, or (2) the end of any qualifying open remedial amendment period, will be eligible for the user fee exemption under § 7528(b)(2)(B), provided that the application satisfies all other applicable requirements for the exemption.

In order to simplify the process for establishing whether the user fee exemption under § 7528(b)(2) is available and, thus, whether a user fee is required to be paid with a determination letter application for a plan, the IRS will, pursuant to the authority under § 7528(b)(2)(A), treat an application as being filed within a qualifying open remedial amendment period (one of the requirements for the user fee exemption) if the plan was first in existence no earlier than January 1 of the tenth calendar year preceding the year in which the application is filed. For example, if an application for a determination letter for a plan that was first in existence during 2007 is filed on December 1, 2017, then the IRS will treat the application as having been filed within a qualifying open remedial amendment period for purposes of § 7528(b)(2). In contrast, if the plan in this example had first been in existence during 2006, then the IRS would not treat the application as being filed within a qualifying open remedial amendment period.

If an application does not satisfy the requirements of the ten-year rule described in the preceding paragraph (and, accordingly, is not treated under that rule as being filed within a qualifying open remedial amendment period), but the application nevertheless satisfies the requirements for the user fee exemption under § 7528(b)(2)(B) (for example, in a case in which a qualifying open remedial amendment period ends more than ten years after the year in which the plan is first in existence), then no user fee is required. In such a case, in lieu of including a user fee with the application, the applicant should explain in a cover letter how the application satisfies the requirements for the exemption under § 7528(b)(2)(B). If the IRS determines that the application does not meet the requirements for the user fee exemption under § 7528(b)(2)(B), the applicant will be asked to submit the required user fee.

IV. Effect on Other Documents

Notice 2002–1 is amplified.

Notice 2011–86 is obsoleted.

V. Effective Date

This notice generally applies to all applications for determination letters that are filed on or after January 1, 2017. However, the rules under Notice 2011–86 continue to apply to (1) an application for a determination letter that is filed on or before January 31, 2017, under Cycle A with respect to an individually designed plan; and (2) an application for a determination letter that is filed on or before April 30, 2017, with respect to a newly approved pre-approved defined contribution plan that is based on the 2010 Cumulative List and adopted on or after January 1, 2016.

VI. DRAFTING INFORMATION

The principal author of this notice is Patrick T. Gutierrez of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice contact Mr. Gutierrez at (202) 317-4148 (not a toll-free number).

Notice 2017–03

Maximum Vehicle Values for 2017 for Use With Vehicle Cents-Per-Mile and Fleet-Average Valuation Rules

PURPOSE

This notice provides the maximum vehicle values for 2017 that taxpayers need to determine the value of personal use of employer-provided vehicles under the special valuation rules provided under section 1.61–21 (d) and (e) of the Income Tax Regulations.

MAXIMUM VEHICLE VALUES

The maximum value of employer-provided vehicles first made available to employees for personal use in calendar year 2017 for which the vehicle cents-per-mile valuation rule provided under Regulation section 1.61–21(e) may be applicable is $15,900 for a passenger automobile and $17,800 for a truck or van.

The maximum value of employer-provided vehicles first made available to employees for personal use in calendar year 2017 for which the fleet-average valuation rule provided under Regulation section 1.61–21(d) may be applicable is $21,100 for a passenger automobile and $23,300 for a truck or van.

EFFECTIVE DATE

This notice applies to employer-provided passenger automobiles first made available to employees for personal use in calendar year 2017.

DRAFTING INFORMATION

The principal author of this notice is Kathleen Edmondson of the Office of Associate Chief Counsel (Tax Exempt & Government Entities). For further information on this notice contact Ms. Edmondson on (202) 317-6798 (not a toll-free number).

Part IV. Items of General Interest

REG–128276–12

Recognition and Deferral of Section 987 Gain or Loss

AGENCY:

Internal Revenue Service (IRS), Treasury.

ACTION:

Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY:

Published elsewhere in this issue of the **Bulletin**, the Treasury Department and the IRS are issuing temporary regulations under section 987 of the Code relating to the recognition and deferral of foreign currency gain or loss under section 987 with respect to a qualified business unit (QBU) in connection with certain QBU terminations and certain other transactions involving partnerships. The temporary regulations also contain rules providing: an annual deemed termination election for a section 987 QBU; an elective method, available to taxpayers that make the annual deemed termination election, for translating all items of income or loss with respect to a section 987 QBU at the yearly average exchange rate; rules regarding the treatment of section 988 transactions of a section 987 QBU; rules regarding QBUs with the U.S. dollar as their functional currency; rules regarding combinations and separations of section 987 QBUs; rules regarding the translation of income used to pay creditable foreign income taxes; and rules regarding the allocation of assets and liabilities of certain partnerships for purposes of section 987. Finally, the temporary regulations contain rules under section 988 requiring the deferral of certain section 988 loss that arises with respect to related-party loans. The text of the temporary regulations serves as the text of these proposed regulations.

DATES:

Written or electronic comments and requests for a public hearing must be received by March 8, 2017.

ADDRESSES:

Send submissions to: CC:PA:LPD:PR (REG–128276–12), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–128276–12), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–128276–12).

FOR FURTHER INFORMATION CONTACT:

Concerning the proposed regulations, Steven D. Jensen at (202) 317-6938; concerning submissions of comments or requests for a public hearing, Regina Johnson, (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by February 6, 2017. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in: (1) §§ 1.987–1(b)(6)(iii)(A) and 1.987–1(g)(3)(i)(E); (2) §§ 1.987–3(b)(4)(iii)(C) and 1.987–1(g)(3)(i)(F); (3) §§ 1.987–3(d) and 1.987–1(g)(3)(i)(G); and (4) §§ 1.987–8(d) and 1.987–1(g)(3)(i)(H). Sections 1.987–1(b)(6)(iii)(A) and 1.987–1(g)(3)(i)(E) allow a controlled foreign corporation to elect to apply section 987 and the regulations thereunder (with certain exceptions) to a dollar QBU. Sections 1.987–3(b)(4)(iii)(C) and 1.987–1(g)(3)(i)(F) allow a taxpayer to elect to apply a foreign currency mark-to-market method of accounting for qualified short-term section 988 transactions. Sections 1.987–3(d) and 1.987–1(g)(3)(i)(G) allow a taxpayer to elect to translate all items of income, gain, deduction, and loss of the section

987 QBU at the yearly average exchange rate. Sections 1.987–8(d) and 1.987–1(g)(3)(i)(H) allow a taxpayer to elect to deem all of its section 987 QBUs to terminate on the last day of each taxable year. The preceding elections are to be made pursuant to § 1.987–1(g). The collection of information is voluntary to obtain a benefit. The likely respondents are business or other for-profit institutions.

Estimated total annual reporting burden: 1,000 hours.

Estimated average annual burden hours per respondent: 1 hour.

Estimated number of respondents: 1,000.

Estimated annual frequency of responses: on occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background and Explanation of Provisions

The temporary regulations (published in the Rules and Regulations section of this issue of the **Bulletin)** contain rules relating to the recognition and deferral of section 987 gain or loss with respect to a QBU. The temporary regulations also contain rules regarding an annual deemed termination election, an elective method for translating taxable income or loss with respect to a QBU, section 988 transactions of a section 987 QBU, QBUs with the U.S. dollar as their functional currency, combinations and separations of section 987 QBUs, translation of income used to pay creditable foreign income taxes, the allocation of assets and liabilities of certain partnerships for purposes of section 987, and the deferral of section 988 loss with respect to certain related-party loans. The text of the temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains those regulations and these proposed regulations.

Special Analyses

Certain IRS regulations, including these, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Accordingly, a regulatory flexibility analysis is not required. This certification is based on the fact that these regulations will primarily affect U.S. corporations that have foreign operations, which tend to be larger businesses. Pursuant to section 7805(f) of

the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the "Addresses" heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. In addition, the Treasury Department and the IRS request comments on the application of section 987 to entities and QBUs described in § 1.987–1(b)(1)(ii) to which the final regulations are not applicable (excluded entities and QBUs). Comments are requested on whether the Treasury Department and the IRS should issue regulations applying the foreign exchange exposure pool methodology described in §§ 1.987–3 and –4 to excluded entities and QBUs. Comments are also requested on the modifications, if any, that should be made to the foreign exchange exposure pool methodology adopted in the final regulations with respect to excluded entities and QBUs. All comments will be available at *www.regulations.gov* or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Mark E. Erwin of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1, as amended elsewhere in this issue of the Federal Register, is proposed to be further amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 985, 987, 989(c) and 7805 * * *

Par. 2. Section 1.987–1 is amended by adding paragraphs (b)(1)(iii), (b)(6), (c)(1)(ii)(B), (c)(3)(i)(E), (d)(3), (f), (g)(2)(i)(B) and (C), and (g)(3)(i)(E) through (H) to read as follows:

§ 1.987–1 Scope, definitions, and special rules.

* * * * *

(b) * * *

(1) * * *

(iii) [The text of the proposed amendment to § 1.987–1(b)(1)(iii) is the same as the text of § 1.987–1T(b)(1)(iii) published elsewhere in this issue of the **Bulletin**].

* * * * *

(6) [The text of the proposed amendment to § 1.987–1(b)(6) is the same as the text of § 1.987–1T(b)(6) published elsewhere in this issue of the **Bulletin**].

* * * * *

(c) * * *

(1) * * *

(ii) * * *

(B) [The text of the proposed amendment to § 1.987–1(c)(1)(ii)(B) is the same as the text of § 1.987–1T(c)(1)(ii)(B) published elsewhere in this issue of the **Bulletin**].

* * * * *

(c) * * *

(3) * * *

(i) * * *

(E) [The text of the proposed amendment to § 1.987–1(c)(3)(i)(E) is the same as the text of § 1.987–1T(c)(3)(i)(E) published elsewhere in this issue of the **Bulletin**].

* * * * *

(d) * * *

(3) [The text of the proposed amendment to § 1.987–1(d)(3) is the same as the text of § 1.987–1T(d)(3) published elsewhere in this issue of the **Bulletin**].

* * * * *

(f) [The text of the proposed amendment to § 1.987–1(f) is the same as the text of § 1.987–1T(f) published elsewhere in this issue of the **Bulletin**].

* * * * *

(g) * * *

(2) * * *

(i) * * *

(B) [The text of the proposed amendment to § 1.987–1(g)(2)(i)(B) is the same as the text of § 1.987–1T(g)(2)(i)(B) published elsewhere in this issue of the **Bulletin**].

(C) [The text of the proposed amendment to § 1.987–1(g)(2)(i)(C) is the same as the text of § 1.987–1T(g)(2)(i)(C) published elsewhere in this issue of the **Bulletin**].

* * * * *

(3) * * *

(i) * * *

(E) [The text of the proposed amendment to § 1.987–1(g)(3)(i)(E) is the same as the text of § 1.987–1T(g)(3)(i)(E) published elsewhere in this issue of the **Bulletin**].

(F) [The text of the proposed amendment to § 1.987–1(g)(3)(i)(F) is the same as the text of § 1.987–1T(g)(3)(i)(F) published elsewhere in this issue of the **Bulletin**].

(G) [The text of the proposed amendment to § 1.987–1(g)(3)(i)(G) is the same as the text of § 1.987–1T(g)(3)(i)(G) published elsewhere in this issue of the **Bulletin**].

(H) [The text of the proposed amendment to § 1.987–1(g)(3)(i)(H) is the same as the text of § 1.987–1T(g)(3)(i)(H) published elsewhere in this issue of the **Bulletin**].

* * * * *

Par. 3. Section 1.987–2 is amended by adding paragraph (c)(9) to read as follows:

§ 1.987–2 Attribution of items to eligible QBUs; definition of a transfer and related rules.

* * * * *

(c) * * *

(9) [The text of the proposed amendment to § 1.987–2(c)(9) is the same as the text of § 1.987–2T(c)(9) published elsewhere in this issue of the **Bulletin**].

* * * * *

Par. 4. Section 1.987–3 is amended by adding paragraphs (b)(2)(ii), (b)(4), (c)(2)(ii) and (v), (d), and *Example 9* through *Example 14* of paragraph (e) to read as follows:

§ 1.987–3 Determination of section 987 taxable income or loss of an owner of a section 987 QBU.

* * * * *

(b) * * *

(2) * * *

(ii) [The text of the proposed amendment to § 1.987–3(b)(2)(ii) is the same as the text of § 1.987–3T(b)(2)(ii) published elsewhere in this issue of the **Bulletin**].

* * * * *

(4) [The text of the proposed amendment to § 1.987–3(b)(4) is the same as the text of § 1.987–3T(b)(4) published elsewhere in this issue of the **Bulletin**].

* * * * *

(c) * * *

(2) * * *

(ii) [The text of the proposed amendment to § 1.987–3(c)(2)(ii) is the same as the text of § 1.987–3T(c)(2)(ii) published elsewhere in this issue of the **Bulletin**].

* * * * *

(v) [The text of the proposed amendment to § 1.987–3(c)(2)(v) is the same as the text of § 1.987–3T(c)(2)(v) published elsewhere in this issue of the **Bulletin**].

(d) [The text of the proposed amendment to § 1.987–3(d) is the same as the text of § 1.987–3T(d) published elsewhere in this issue of the **Bulletin**].

(e) *Examples*. * * *

Example 9 [The text of the proposed amendment to § 1.987–3(e) *Example 9* is the same as the text of § 1.987–3T(e) *Example 9* published elsewhere in this issue of the **Bulletin**].

Example 10 [The text of the proposed amendment to § 1.987–3(e) *Example 10* is the same as the text of § 1.987–3T(e) *Example 10* published elsewhere in this issue of the **Bulletin**].

Example 11 [The text of the proposed amendment to § 1.987–3(e) *Example 11* is the same as the text of § 1.987–3T(e) *Example 11* published elsewhere in this issue of the **Bulletin**].

Example 12 [The text of the proposed amendment to § 1.987–3(e) *Example 12* is the same as the text of § 1.987–3T(e) *Example 12* published elsewhere in this issue of the **Bulletin**].

Example 13 [The text of the proposed amendment to § 1.987–3(e) *Example 13* is the same as the text of § 1.987–3T(e) *Example 13* published elsewhere in this issue of the **Bulletin**].

Example 14 [The text of the proposed amendment to § 1.987–3(e) *Example 14* is the same as the text of § 1.987–3T(e) *Example 14* published elsewhere in this issue of the **Bulletin**].

Par. 5. Section 1.987–4 is amended by adding paragraphs (c)(2) and (f) to read as follows:

§ 1.987–4 Determination of net unrecognized section 987 gain or loss of a section 987 QBU.

* * * * *

(c) * * *

(2) [The text of the proposed amendment to § 1.987–4(c)(2) is the same as the text of § 1.987–4T(c)(2) published elsewhere in this issue of the **Bulletin**].

* * * * *

(f) [The text of the proposed amendment to § 1.987–4(f) is the same as the text of § 1.987–4T(f) published elsewhere in this issue of the **Bulletin**].

* * * * *

Par. 6. Section 1.987–6 is amended by adding paragraph (b)(4) to read as follows:

§ 1.987–6 Character and source of section 987 gain or loss.

* * * * *

(b) * * *

(4) [The text of the proposed amendment to § 1.987–6(b)(4) is the same as the text of § 1.987–6T(b)(4) published elsewhere in this issue of the **Bulletin**].

* * * * *

Par. 7. Section 1.987–7 is amended by adding paragraph (b) to read as follows:

§ 1.987–7 Section 987 aggregate partnerships.

* * * * *

(b) [The text of the proposed amendment to § 1.987–7(b) is the same as the text of § 1.987–7T(b) published elsewhere in this issue of the **Bulletin**].

* * * * *

Par. 8. Section 1.987–8 is amended by adding paragraph (d) to read as follows:

§ 1.987–8 Termination of a section 987 QBU.

* * * * *

(d) [The text of the proposed amendment to § 1.987–8(d) is the same as the text of § 1.987–8T(d) published elsewhere in this issue of the **Bulletin**].

* * * * *

Par. 9. Section 1.987–12 is revised to read as follows:

§ 1.987–12 Deferral of section 987 gain or loss.

[The text of the proposed amendment to § 1.987–12 is the same as the text of § 1.987–12T published elsewhere in this issue of the **Bulletin**].

Par. 10. Section 1.988–1 is amended by adding paragraph (a)(3) to read as follows:

***§ 1.988–1 Certain definitions and special rules*.**

* * * * *

(a) * * *

(3) [The text of the proposed amendment to § 1.988–1(a)(3) is the same as the text of § 1.988–1T(a)(3) published elsewhere in this issue of the **Bulletin**].

* * * * *

Par. 11. Section 1.988–2 is amended by revising paragraph (b)(16) and adding paragraph (i) to read as follows:

***§ 1.988–2 Recognition and computation of exchange gain or loss*.**

* * * * *

(b) * * *

(16) [The text of the proposed amendment to § 1.988–2(b)(16) is the same as the text of § 1.988–2T(b)(16) published elsewhere in this issue of the **Bulletin**].

* * * * *

(i) [The text of the proposed amendment to § 1.988–2(i) is the same as the text of § 1.988–2T(i) published elsewhere in this issue of the **Bulletin**].

John Dalrymple, *Deputy Commissioner for Services and Enforcement.*

Note

(Filed by the Office of the Federal Register on December 7, 2016, 8:45 a.m., and published in the issue of the Federal Register for December 8, 2016, 81 F.R. 88882)

REG–133353–16

Disclosures of Return Information Reflected on Returns to Officers and Employees of the Department of Commerce for Certain Statistical Purposes and Related Activities

AGENCY:

Internal Revenue Service (IRS), Treasury.

ACTION:

Notice of proposed rulemaking by cross-reference to temporary regulation.

SUMMARY:

In the Rules and Regulations section of this issue of the **Bulletin** the IRS is issuing temporary regulations authorizing the disclosure of specified return information to the Bureau of the Census (Bureau) for purposes of structuring the censuses and national economic accounts and conducting related statistical activities authorized by title 13. The temporary regulations are made pursuant to a request from the Secretary of Commerce. The temporary regulations also provide clarifying language for an item of return information and remove duplicative paragraphs contained in the existing final regulations. These regulations require no action by taxpayers and have no effect on their tax liabilities. Thus, no taxpayers are likely to be affected by the disclosures authorized by this guidance. The text of the temporary regulations published in the Rules and Regulations section of the **Federal Register** serves as the text of these proposed regulations.

DATES:

Written and electronic comments and requests for a public hearing must be received by March 9, 2017.

Applicability Date: For dates of applicability, see § 301.6103(j)(1)–1(e).

ADDRESSES:

Send submissions to CC:PA:LPD:PR (REG–133353–16), room 5203, Internal Revenue Service, Post Office Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–133353–16), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224, or sent electronically, via the Federal eRulemaking Portal at *www.regulations.gov* (IRS REG–133353–16).

FOR FURTHER INFORMATION CONTACT:

Concerning the proposed regulations, William Rowe, (202) 317-6834; concerning submissions of comments, Regina Johnson, (202) 317-5177 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document contains proposed amendments to 26 CFR part 301 relating to section 6103(j)(1)(A) of the Internal Revenue Code (Code). Section 6103(j)(1)(A) authorizes the Secretary of the Treasury to furnish, upon written request by the Secretary of Commerce, such returns or return information as the Secretary of Treasury may prescribe by regulation to officers and employees of the Bureau for the purpose of, but only to the extent necessary in, the structuring of censuses and national economic accounts and conducting related statistical activities authorized by law. Section 301.6103(j)(1)–1 of the regulations further

defines such purposes by reference to 13 U.S.C. chapter 5 and provides an itemized description of the return information authorized to be disclosed for such purposes. This document contains proposed regulations authorizing the disclosure of additional items of return information requested by the Secretary of Commerce. These proposed regulations also provide clarifying language for an item of return information and remove duplicative paragraphs contained in the existing regulations. Temporary regulations in the Rules and Regulations section of this issue of the **Bulletin** amend 26 CFR part 301. The text of those temporary regulations serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations and these proposed regulations.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities because the regulations do not impose a collection of information on small entities. Accordingly, a regulatory flexibility analysis is not required under the Regulatory Flexibility Act (5 U.S.C. chapter 6). Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the “Addresses” heading. The IRS and Treasury Department request comments on all aspects of the proposed regulations. All comments that are submitted will be available for public inspection and copying at *www.regulations.gov* or upon request. A public hearing may be scheduled if requested in writing by any person that timely submits written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is William Rowe, Office of the Associate Chief Counsel (Procedure & Administration).

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 301.6103(j)(1)–1 is amended by adding paragraphs (b)(2)(iii)(K) through (M), (b)(3)(xxxi) through (xxxv), and (b)(6)(i)(C) through (E), and revising paragraphs (b)(2)(iii)(I), (b)(3)(xxv) through (xxx), and (e) to read as follows:

§ 301.6103(j)(1)–1 Disclosures of return information reflected on returns to officers and employees of the Department of Commerce for certain statistical purposes and related activities.

* * * * *

(b) * * *

(2) * * *

(iii) * * *

(I) [The text of proposed amendments to § 301.6103(j)(1)–1(b)(2)(iii)(I) is the same as the text of § 301.6103(j)(1)–1T(b)(2)(iii)(I) published elsewhere in this issue of the **Bulletin**].

* * * * *

(K) through (M) [The text of proposed amendments to § 301.6103(j)(1)–1(b)(2)(iii)(K) through (M) is the same as the text of § 301.6103(j)(1)–1T(b)(2)(iii)(K) through (M) published elsewhere in this issue of the **Bulletin**].

* * * * *

(3) * * *

(v) [The text of proposed amendments to § 301.6103(j)(1)–1(b)(3)(v) is the same as the text of § 301.6103(j)(1)–1T(b)(3)(v) published elsewhere in this issue of the **Bulletin**].

* * * * *

(xxv) through (xxxv) [The text of proposed amendments to § 301.6103(j)(1)–1(b)(3)(xxv) through (xxxv) is the same as the text of § 301.6103(j)(1)–1T(b)(3)(xxv) through (xxxv) published elsewhere in this issue of the **Bulletin**].

* * * * *

(6) * * *

(i) * * *

(C) through (E) [The text of proposed amendments to § 301.6103(j)(1)–1T(b)(6)(i)(C) through (E) is the same as the text of § 301.6103(j)(1)–1T(b)(6)(i)(C) through (E) published elsewhere in this issue of the **Bulletin**].

* * * * *

(e) *Applicability date*. Paragraphs (b)(2)(iii)(I), (b)(2)(iii)(K) through (M), (b)(3)(v), (b)(3)(xxv) through (xxxv), and (b)(6)(i)(C) through (E) of this section apply to disclosure of the Bureau of the Census made on or after December 9, 2016. For rules that apply to disclosure to the Bureau of the Census before that date, see 26 CFR 301.6103(j)(1)–1 (revised as of April 1, 2016).

John Dalrymple, *Deputy Commissioner for Services and Enforcement.*

Note

(Filed by the Office of the Federal Register on December 8, 2016, 8:45 a.m., and published in the issue of the Federal Register for December 9, 2016, 81 F.R. 89022)

REG–134438–15

Health Insurance Providers Fee

AGENCY:

Internal Revenue Service (IRS), Treasury.

ACTION:

Notice of proposed rulemaking.

SUMMARY:

This document contains proposed regulations that would modify the current definition of “net premiums written” for purposes of the fee imposed by section 9010 of the Patient Protection and Affordable Care Act, as amended. The proposed regulations will affect persons engaged in the business of providing health insurance for United States health risks.

DATES:

Comments and requests for a public hearing must be received by March 9, 2017.

ADDRESSES:

Send submissions to: CC:PA:LPD:PR (REG–134438–15), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–134438–15), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224, or sent electronically, via the Federal eRulemaking portal at www.regulations.gov (IRS REG–134438–15)

FOR FURTHER INFORMATION CONTACT:

Concerning the proposed regulations, Rachel S. Smith, (202) 317-6855; concerning submissions of comments and request for a hearing, Regina Johnson, (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 9010 of the Patient Protection and Affordable Care Act (PPACA), Public Law No. 111–148 (124 Stat. 119 (2010)), as amended by section 10905 of PPACA, and as further amended by section 1406 of the Health Care and Education Reconciliation Act of 2010, Public Law 111–152 (124 Stat. 1029 (2010)) (collectively, the Affordable Care Act or ACA) imposes an annual fee on covered entities that provide health insurance for United States health risks. Section 9010 did not amend the Internal Revenue Code (Code) but contains cross-references to specified Code sections. In this preamble all references to section 9010 are references to section 9010 of the ACA and all references to ''fee'' are references to the fee imposed by section 9010.

Section 9010(a) imposes an annual fee on each covered entity engaged in the business of providing health insurance. The fee is due by the annual date specified by the Secretary, but in no event later than September 30th of each calendar year in which a fee must be paid (fee year).

Section 9010(b) requires the Secretary to determine the annual fee for each covered entity based on the ratio of the covered entity's net premiums written for health insurance for any United States health risk that are taken into account for the calendar year immediately before the fee year (data year) to the aggregate net premiums written for health insurance of United States health risks of all covered entities that are taken into account during the data year. In calculating the fee, the Secretary must determine each covered entity's net premiums written for United States health risks based on reports submitted to the Secretary by the covered entity and through the use of any other source of information available to the Secretary. Section 9010 does not define the term "net premiums written."

On November 29, 2013, the Treasury Department and the IRS published in the **Federal Register** (TD 9643; 78 FR 71476) final regulations regarding the fee (final regulations). The final regulations define *net premiums written* to mean premiums written, including reinsurance premiums written, reduced by reinsurance ceded, and reduced by ceding commissions and medical loss ratio (MLR) rebates with respect to the data year. Net premiums written do not include premiums written for indemnity reinsurance (and are not reduced by indemnity reinsurance ceded) because indemnity reinsurance is not considered health insurance for purposes of section 9010. However, net premiums written do include premiums written (and are reduced by premiums ceded) for assumption reinsurance; that is, reinsurance for which there is a novation and the reinsurer takes over the entire risk.

The preamble to the final regulations explained that, for covered entities that file the Supplemental Health Care Exhibit (SHCE) with the National Association of Insurance Commissioners (NAIC), net premiums written for health insurance generally will equal the amount reported on the SHCE as direct premiums written minus MLR rebates with respect to the data year, subject to any applicable exclusions under section 9010. The instructions to Form 8963, *Report of Health Insurance Provider Information*, provide additional information on how to determine net premiums written using the SHCE and any equivalent forms as the source of data, and can be updated to reflect changes to the SHCE.

Explanation of Provisions

The proposed regulations would amend and clarify the rules for how "net premiums written" take into account certain premium adjustments and payments.

1. *Retrospective Premium Adjustments*

Following the publication of the final regulations, the Treasury Department and the IRS received comments requesting that premium adjustments related to retrospectively rated contracts be taken into account in determining net premiums written. The NAIC's Accounting Practices and Procedures Manual Statement of Statutory Accounting Principles No. 66, *Retrospectively Rated Contracts*, defines a retrospectively rated contract as a contract which has the final policy premium calculated based on the loss experience of the insured during the term of the policy (including loss development after the term of the policy) and on the stipulated formula set forth in the policy or a formula required by law. These premium adjustments, made periodically, may involve either the payment of return premium to the insured (a "retrospectively rated contract payment") or payment of an additional premium by the insured (a "retrospectively rated contract receipt"), or both, depending on experience.

Commenters recommended that in calculating net premiums written, premiums written should be increased by retrospectively rated contract receipts and reduced by retrospectively rated contract payments. Commenters asserted that retrospectively rated contract payments are refunded to policyholders in much the same way as MLR rebates. Therefore, without an adjustment for retrospectively rated contract payments, covered entities that make these payments will bear a liability for an amount of the annual fee that correlates to premiums from which they do not actually receive an economic benefit.

In response to these comments, the proposed regulations would modify the current definition of net premiums written to account for premium adjustments related to retrospectively rated contracts, computed on an accrual basis. These amounts are received from and paid to policyholders annually based on experience. Retrospectively rated contract receipts and payments do not include changes to funds or accounts that remain under the control of the covered entity, such as changes to premium stabilization reserves.

2. *Risk Adjustment Payments and Charges*

Following the publication of the final regulations, questions also arose about the treatment of risk adjustment payments under the ACA. Section 1343 of the ACA provides a permanent risk adjustment program for certain plans in the individual and small group markets. In general, the program transfers risk adjustment funds from health insurance plans with relatively lower-risk enrollees to issuers that disproportionately attract high-risk populations, such as individuals with chronic conditions. Section 1343(a)(1) generally requires each state, or the Department of Health and Human Services (HHS) acting on behalf of the state, to assess a charge on health plans and health insurance issuers in the individual or small group markets within a state (with respect to health insurance coverage) if the actuarial risk of the enrollees of such plans or coverage for a year is less than the average actuarial risk of all enrollees in all plans or coverage in the state for the year that are not self-insured group health plans. Section 1343(a)(2) generally requires each state, or HHS acting on behalf of the state, to make a payment to health plans and health insurance issuers in the individual or small group markets within a state (with respect to health insurance coverage) if the actuarial risk of the enrollees of such plans or coverage for a year is greater than the average actuarial risk of all enrollees in all plans and coverage in the state for the year that are not self-insured group health plans.

Although not specifically listed, net premiums written, as defined in the final regulations, include risk adjustment payments received by a covered entity under section 1343(a)(2) of the ACA and are reduced for risk adjustment charges paid by a covered entity under section 1343(a)(1) of the ACA. Nonetheless, several covered entities asked whether net premiums written included risk adjustment payments received and charges paid. Therefore, these proposed regulations add specific language to the definition of net premiums written to clarify that net premiums written include risk adjustment payments received and are reduced for risk adjustment charges paid. If a covered entity did not include risk adjustment payments received as direct premiums written on its SHCE or did not file an SHCE, these amounts are still part of net premiums written and must be reported as such on Form 8963. For this purpose, risk adjustment payments received and charges paid are computed on an accrual basis.

3. *Other Premium Adjustments*

These proposed regulations would authorize the IRS to provide rules in guidance published in the Internal Revenue Bulletin for additional amounts to be taken into account in determining net premiums written. If the Treasury Department and the IRS determine that published guidance providing additional adjustments to net premiums written is warranted, such guidance will be published in the Internal Revenue Bulletin.

Proposed Effective/Applicability Date

These regulations are proposed to apply with respect to any fee that is due on or after September 30, 2018.

Special Analyses

Certain IRS regulations, including these, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory assessment is not required. Because these regulations do not include a collection of information, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to Code section 7805(f), this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. Comments are requested on all aspects of these proposed regulations. The Treasury Department and the IRS specifically request comments on the following:

1. How the adjustments to net premiums written under these proposed regulations tie to amounts reported on the SHCE.

2. Whether there should be a transition rule for premium adjustments related to retrospectively rated contracts and how any such rule should be implemented.

All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the Federal Register.

Drafting Information

The principal author of these proposed regulations is Rachel S. Smith, IRS Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the Treasury Department and the IRS participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 57 is proposed to be amended as follows:

PART 57—HEALTH INSURANCE PROVIDERS FEE

Paragraph 1. The authority citation for part 57 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

* * * * *

Par. 2. Section 57.2 is amended by revising paragraph (k) to read as follows:

***§ 57.2 Explanation of terms*.**

* * * * *

(k) *Net premiums written*—(1) *In general*. The term *net premiums written* means premiums written, adjusted as provided in paragraph (k)(2) of this section.

(2) *Adjustments*. Net premiums written include adjustments to account for:

(i) *Assumption reinsurance, but not indemnity reinsurance*. Net premiums written include reinsurance premiums written, reduced by reinsurance ceded, and reduced by ceding commissions with respect to the data year. Net premiums written do not include premiums written for indemnity reinsurance and are not reduced by indemnity reinsurance ceded because indemnity reinsurance within the meaning of paragraph (h)(5)(i) of this section is not health insurance under paragraph (h)(1) of this section. However, in the case of assumption reinsurance within the meaning of paragraph (h)(5)(ii) of this section, net premiums written include premiums written for assumption reinsurance, reduced by assumption reinsurance premiums ceded.

(ii) *Medical loss ratio (MLR) rebates*. Net premiums written are reduced by MLR rebates with respect to the data year. For this purpose, MLR rebates are computed on an accrual basis.

(iii) *Premium adjustments related to retrospectively rated contracts*. Net premiums written include retrospectively rated contract receipts and are reduced by retrospectively rated contract payments with respect to the data year. For this purpose, net premium adjustments related to retrospectively rated contracts are computed on an accrual basis.

(iv) *Amounts related to the risk adjustment program under section 1343 of the ACA*. Net premiums written include risk adjustment payments (within the meaning of 42 U.S.C. 18063(b)) received with respect to the data year and are reduced by risk adjustment charges (within the meaning of 42 U.S.C. 18063(a)) paid with respect to the data year. For this purpose, risk adjustment payments and risk adjustment charges are computed on an accrual basis.

(v) *Additional adjustments published in the Internal Revenue Bulletin*. The IRS may provide rules in guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter) for additional adjustments against premiums written in determining net premiums written.

Par. 3. Section 57.10 is amended by revising paragraph (a) and adding paragraph (c) to read as follows:

***§ 57.10 Effective/applicability date*.**

(a) *In general*. Except as provided in paragraphs (b) and (c) of this section, §§ 57.1 through 57.9 apply to any fee that is due on or after September 30, 2014.

* * * * *

(c) *Paragraph (k) of § 57.2*. Paragraph (k) of § 57.2 applies to any fee that is due on or after September 30, 2018.

John Dalrymple, *Deputy Commissioner for Services and Enforcement.*

Note

(Filed by the Office of the Federal Register on December 8, 2016, 8:45 a.m., and published in the issue of the Federal Register for December 9, 2016, 81 F.R. 89017)

Definition of Terms and Abbreviations

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.

Acq.—Acquiescence.

B—Individual.

BE—Beneficiary.

BK—Bank.

B.T.A.—Board of Tax Appeals.

C—Individual.

C.B.—Cumulative Bulletin.

CFR—Code of Federal Regulations.

CI—City.

COOP—Cooperative.

Ct.D.—Court Decision.

CY—County.

D—Decedent.

DC—Dummy Corporation.

DE—Donee.

Del. Order—Delegation Order.

DISC—Domestic International Sales Corporation.

DR—Donor.

E—Estate.

EE—Employee.

E.O.—Executive Order.

ER—Employer.

ERISA—Employee Retirement Income Security Act.

EX—Executor.

F—Fiduciary.

FC—Foreign Country.

FICA—Federal Insurance Contributions Act.

FISC—Foreign International Sales Company.

FPH—Foreign Personal Holding Company.

F.R.—Federal Register.

FUTA—Federal Unemployment Tax Act.

FX—Foreign corporation.

G.C.M.—Chief Counsel's Memorandum.

GE—Grantee.

GP—General Partner.

GR—Grantor.

IC—Insurance Company.

I.R.B.—Internal Revenue Bulletin.

LE—Lessee.

LP—Limited Partner.

LR—Lessor.

M—Minor.

Nonacq.—Nonacquiescence.

O—Organization.

P—Parent Corporation.

PHC—Personal Holding Company.

PO—Possession of the U.S.

PR—Partner.

PRS—Partnership.

PTE—Prohibited Transaction Exemption.

Pub. L.—Public Law.

REIT—Real Estate Investment Trust.

Rev. Proc.—Revenue Procedure.

Rev. Rul.—Revenue Ruling.

S—Subsidiary.

S.P.R.—Statement of Procedural Rules.

Stat.—Statutes at Large.

T—Target Corporation.

T.C.—Tax Court.

T.D.—Treasury Decision.

TFE—Transferee.

TFR—Transferor.

T.I.R.—Technical Information Release.

TP—Taxpayer.

TR—Trust.

TT—Trustee.

U.S.C.—United States Code.

X—Corporation.

Y—Corporation.

Z—Corporation.

Numerical Finding List

Numerical Finding List

A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2016–27 through 2016–52 is in Internal Revenue Bulletin 2016–52, dated December 26, 2016.

Bulletin 2017–1 through 2017–2

Notices:

Article	Issue	Link	Page
2017-1	2017-02 I.R.B.	2017-02	367
2017-3	2017-02 I.R.B.	2017-02	368

Proposed Regulations:

Article	Issue	Link	Page
REG-128276-12	2017-02 I.R.B.	2017-02	369
REG-134438-15	2017-02 I.R.B.	2017-02	373
REG-133353-16	2017-02 I.R.B.	2017-02	372

Revenue Procedures:

Article	Issue	Link	Page
2017-1	2017-01 I.R.B.	2017-01	1
2017-2	2017-01 I.R.B.	2017-01	106
2017-3	2017-01 I.R.B.	2017-01	130
2017-4	2017-01 I.R.B.	2017-01	146
2017-5	2017-01 I.R.B.	2017-01	230
2017-7	2017-01 I.R.B.	2017-01	269

Revenue Rulings:

Article	Issue	Link	Page
2017-2	2017-02 I.R.B.	2017-02	364

Treasury Decisions:

Article	Issue	Link	Page
9794	2017-02 I.R.B.	2017-02	273
9795	2017-02 I.R.B.	2017-02	326
9801	2017-02 I.R.B.	2017-02	355
9802	2017-02 I.R.B.	2017-02	361

Effect of Current Actions on Previously Published Items

Finding List of Current Actions on Previously Published Items

A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2016–27 through 2016–52 is in Internal Revenue Bulletin 2016–52, dated December 26, 2016.

Bulletin 2017–1 through 2017–2

Notices:

Old Article	Action	New Article	Issue	Link	Page
2002-1	Amplified by	Notice 2017-1	2017-02 I.R.B.	2017-02	367
2011-86	Obsoleted by	Notice 2017-1	2017-02 I.R.B.	2017-02	367

INTERNAL REVENUE BULLETIN

The Introduction at the beginning of this issue describes the purpose and content of this publication. The weekly Internal Revenue Bulletins are available at *www.irs.gov/irb/*.

We Welcome Comments About the Internal Revenue Bulletin

If you have comments concerning the format or production of the Internal Revenue Bulletin or suggestions for improving it, we would be pleased to hear from you. You can email us your suggestions or comments through the IRS Internet Home Page (*www.irs.gov*) or write to the

Internal Revenue Service, Publishing Division, IRB Publishing Program Desk, 1111 Constitution Ave. NW, IR-6230 Washington, DC 20224.

Page Last Reviewed or Updated: 27-Sep-2018

This document is scheduled to be published in the
Federal Register on 12/19/2017 and available online at
https://federalregister.gov/d/2017-27320, and on **FDsys.gov**

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-119514-15]

RIN 1545-BM80

Exclusion of Foreign Currency Gain or Loss Related to Business Needs from Foreign Personal Holding Company Income; Mark-to-Market Method of Accounting for Section 988 Transactions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance on the treatment of foreign currency gain or loss of a controlled foreign corporation (CFC) under the business needs exclusion from foreign personal holding company income (FPHCI). The proposed regulations also provide an election for a taxpayer to use a mark-to-market method of accounting for foreign currency gain or loss attributable to section 988 transactions. In addition, the proposed regulations permit the controlling United States shareholders of a CFC to automatically revoke certain elections concerning the treatment of foreign currency gain or loss. The proposed regulations affect taxpayers and United States shareholders of CFCs that engage in transactions giving rise to foreign currency gain or loss under section 988 of the Internal Revenue Code (Code).

DATES: Written or electronic comments and requests for a public hearing must be received by [**INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER**].

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG-119514-15), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-119514-15), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at http://www.regulations.gov (IRS REG-119514-15).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jeffery G. Mitchell, (202) 317-6934; concerning submissions of comments or requests for a public hearing, Regina Johnson, (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC

20224. Comments on the collection of information should be received by **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the duties of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchases of services to provide information.

The collection of information in these proposed regulations is in proposed §§1.954-2(g)(3)(iii) and (4)(iii) and 1.988-7. The information is required to be provided by taxpayers and United States shareholders of CFCs that make an election or revoke an election with respect to the treatment of foreign currency gains and losses. The information provided will be used by the IRS for tax compliance purposes.

Estimated total annual reporting burden: 5,000 hours.

Estimated average annual burden hours per respondent: one hour.

Estimated number of respondents: 5,000.

Estimated annual frequency of responses: one.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains proposed amendments to 26 CFR part 1 under sections 446, 954(c)(1)(D), and 988 of the Code. Section 446 requires taxpayers to compute taxable income using accounting methods that clearly reflect income. Section 954(c)(1)(D) provides that FPHCI includes the excess of foreign currency gains over foreign currency losses (as defined in section 988(b)) attributable to section 988 transactions, other than transactions directly related to the business needs of the CFC. Section 988 provides rules for determining the source and character of gain or loss from certain foreign currency transactions.

A. Business Needs Exclusion

1. In general

Section 954 defines foreign base company income (FBCI), which generally is income earned by a CFC that is taken into account in computing the amount that a United States shareholder of the CFC must include in income under section 951(a)(1)(A). Under section 954(a)(1), FBCI includes FPHCI, which is defined in

section 954(c). The excess of foreign currency gains over foreign currency losses from section 988 transactions is generally included in FPHCI pursuant to section 954(c)(1)(D).

Section 988 transactions generally include the following: the accrual of any item of income or expense that is to be paid or received in a nonfunctional currency after the date of accrual; lending or borrowing in a nonfunctional currency; entering into or acquiring a forward, future, option, or similar contract denominated in a nonfunctional currency; and the disposition of nonfunctional currency. See section 988(c). Thus, accruals in connection with ordinary business transactions, such as purchases and sales of inventory or the provision of services, are section 988 transactions if the receivable or payable is denominated in, or determined by reference to, a currency other than the taxpayer's functional currency, as determined under §1.985-1.

Notwithstanding the general rule that includes the excess of foreign currency gains over foreign currency losses from section 988 transactions in FPHCI, section 954(c)(1)(D) excludes from FPHCI any foreign currency gain or loss attributable to a transaction directly related to the business needs of the CFC (business needs exclusion). To qualify for the business needs exclusion, a foreign currency gain or loss must, in addition to satisfying other requirements, arise from a transaction entered into, or property used, in the normal course of the CFC's business that does not itself (and could not reasonably be expected to) give rise to subpart F income (as defined in section 952) other than foreign currency gain or loss. See §1.954-2(g)(2)(ii)(B)(1).

Foreign currency gain or loss attributable to a bona fide hedging transaction (as defined in §1.954-2(a)(4)(ii)) with respect to a transaction or property that qualifies for

the business needs exclusion also qualifies for the business needs exclusion, provided that any gain or loss with respect to such transaction or property that is attributable to changes in exchange rates is clearly determinable from the records of the CFC as being derived from such property or transaction. See §1.954-2(g)(2)(ii)(B)(2). Generally, bona fide hedging transactions are transactions that meet the requirements for a hedging transaction under §1.1221-2(a) through (d), except that a bona fide hedging transaction also includes a transaction entered into in the normal course of business primarily to manage risk with respect to section 1231 property or a section 988 transaction. Under §1.1221-2(b), a hedging transaction is defined as a transaction that a taxpayer enters into in the normal course of its trade or business primarily to manage the risk of price changes or currency fluctuations with respect to ordinary property that is held or to be held by the taxpayer, or to manage the risk of interest rate or price changes or currency fluctuations with respect to borrowings made or to be made, or ordinary obligations incurred or to be incurred, by the taxpayer. Transactions that manage risks related to assets that would produce capital gain or loss on disposition (capital assets), or assets owned or liabilities owed by a related party, do not qualify as hedging transactions under §1.1221-2(b). To qualify as a bona fide hedging transaction, the transaction must be clearly identified as a hedging transaction before the end of the day on which the CFC acquired, originated, or entered into the transaction. See §§1.1221-2(f) and 1.954-2(a)(4)(ii)(A) and (B).

Section 1.954-2(g)(2)(ii)(C) provides special rules for applying the business needs exclusion to CFCs that are regular dealers as defined in §1.954-2(a)(4)(iv). Transactions in dealer property (as defined in §1.954-2(a)(4)(v)) that are entered into by

a CFC that is a regular dealer in such property in its capacity as a dealer are treated as directly related to the business needs of the CFC. See §1.954-2(g)(2)(ii)(C)(1). In addition, an interest-bearing liability denominated in a nonfunctional currency and incurred by a regular dealer is treated as dealer property if it reduces the CFC's currency risk with respect to dealer property and is identified on the CFC's records as a liability treated as dealer property. See §1.954-2(g)(2)(ii)(C)(2). A regular dealer is a CFC that regularly and actively offers to, and in fact does, purchase property from and sell property to unrelated customers in the ordinary course of business, or that regularly and actively offers to, and in fact does, enter into, assume, offset, assign or otherwise terminate positions in property with unrelated customers in the ordinary course of business. See §1.954-2(a)(4)(iv).

2. Use of net foreign currency losses

Under section 954(c)(1)(D), although a foreign currency loss that does not qualify for the business needs exclusion reduces the amount of foreign currency gain that is included in FPHCI, an excess of foreign currency losses over foreign currency gains from section 988 transactions generally does not reduce FPHCI. Such a net foreign currency loss does, however, reduce earnings and profits for purposes of the current earnings and profits limitation on subpart F income in section 952(c)(1). Additionally, as described in Part D of this Background section, when an election under §1.954-2(g)(3) or (4) is in effect, a foreign currency loss can reduce FPHCI or, in the case of an election under §1.954-2(g)(3), another category of subpart F income.

3. Inapplicability of business needs exclusion to transactions and property that give rise to both subpart F income and non-subpart F income

In order for the business needs exclusion to apply to exclude foreign currency gain and loss from the computation of FPHCI, the foreign currency gain or loss must arise from a transaction or property that does not itself (and could not reasonably be expected to) give rise to any subpart F income other than foreign currency gain or loss. For example, foreign currency gains and losses related to the purchase and sale of inventory are excluded from the computation of FPHCI if none of the income from the purchase and sale is subpart F income under section 952. However, if the transaction or property gives rise to, or could reasonably be expected to give rise to, any amount of subpart F income (other than foreign currency gain or loss), none of the foreign currency gain or loss attributable to the transaction or property would qualify for the business needs exclusion. Thus, there is a cliff effect: if even a de minimis amount of income or gain from the transaction or property is subpart F income, the entire amount of the foreign currency gain or loss from the transaction or property, or from a bona fide hedging transaction with respect to the transaction or property, is included in the FPHCI computation.

4. Transactions that manage the risk of currency fluctuation in a qualified business unit

A CFC may conduct business through a qualified business unit (as defined in §1.989(a)-1) (QBU) that is not treated as a separate entity for federal income tax purposes, either because it is a branch or division of the CFC or because it is a business entity that is disregarded as separate from its owner. Although the QBU is not treated as a separate entity, it may have a functional currency under §1.985-1 that is different from that of the CFC owner, with consequences for the determination of foreign currency gain and loss under sections 987 and 988. The QBU's transactions in its own

functional currency are not section 988 transactions of the CFC, and accordingly the CFC does not realize foreign currency gain or loss on such transactions. The CFC generally must, however, take into account under section 987 foreign currency gain or loss with respect to the QBU upon remittances from the QBU.

For business and financial accounting reasons, a CFC may enter into transactions to manage the exchange rate risk associated with its net investment in its QBU. Under generally accepted accounting principles in the United States (U.S. GAAP), a majority owner of a business entity (parent corporation) must consolidate the accounts of the majority-owned entity, including a foreign entity, with its own accounts for purposes of financial reporting. Under U.S. GAAP, the income, assets, liabilities, and other financial results of foreign operations that are conducted in a functional currency that differs from the consolidated parent's functional currency must be translated into the functional currency of the consolidated parent. Foreign currency gains or losses arising from the translation are recorded in a "cumulative translation adjustment" account and reported as a component of shareholders' equity on the balance sheet. See generally Accounting Standards Codification (ASC) 830-30-45. Foreign currency gain or loss from transactions that effectively hedge the risk of currency fluctuations in the net equity investment in foreign operations also are recorded in the cumulative translation adjustment account. See ASC 815-35-35. A cumulative translation adjustment is not taken into account in computing the income of the consolidated group until the relevant operations are disposed of or liquidated.

The transactions that a CFC uses to manage its exchange rate risk with respect to its net investment in a QBU are typically section 988 transactions. Thus, foreign

currency gains or losses attributable to those transactions are taken into account in computing FPHCI, unless the transactions qualify as bona fide hedging transactions that satisfy the requirements of the business needs exclusion. See §1.954-2(g)(2)(ii)(B)(2). Neither the Code nor the section 954 regulations provide specific guidance on whether a transaction entered into to manage exchange rate risk arising from a CFC's net investment in a QBU can qualify as a bona fide hedging transaction eligible for the business needs exclusion. This issue can be consequential because foreign currency gain, but not loss, from a transaction erroneously identified as a bona fide hedging transaction is included in the computation of FPHCI, unless the CFC qualifies for the inadvertent identification exception. See §1.954-2(a)(4)(ii)(C) and (g)(2)(ii)(B)(2). Additionally, even if a transaction entered into to manage exchange rate risk arising from a CFC's net investment in a QBU is eligible for treatment as a bona fide hedging transaction, the transaction would not qualify for the business needs exclusion unless the hedged property did not, and could not reasonably be expected to, give rise to any subpart F income.

Also for business and financial accounting reasons, a CFC may enter into transactions to manage the exchange rate risk with respect to its net investment in a subsidiary CFC. A transaction that manages the risk of price or currency fluctuation with respect to a CFC's net investment in a subsidiary CFC is not considered a hedging transaction for federal income tax purposes. In Hoover Co. v. Commissioner, 72 T.C. 706 (1979), the Tax Court held that transactions entered into to manage the risk of a decline in value of a taxpayer's net investment in a foreign subsidiary that might occur if the value of the subsidiary's functional currency declined relative to the U.S. dollar were

not hedging transactions for federal income tax purposes. See also §1.1221-2(b) (providing that a hedging transaction must manage risk with respect to "ordinary property … that is held or to be held by the taxpayer"). Thus, foreign currency gains and losses on transactions that manage the risk of currency fluctuation on a CFC's net investment in a subsidiary CFC are taken into account in computing FPHCI.

B. Timing of Foreign Currency Gains and Losses

1. Hedge timing rules of §1.446-4

Section 1.446-4 generally requires gain or loss from a hedging transaction, as defined in §1.1221-2(b), to be taken into account at the same time as the gain or loss from the item being hedged. As noted in Part A.1 of this Background section, bona fide hedging transactions under §1.954-2(a)(4)(ii) include both hedging transactions as defined in §1.1221-2(b) and transactions that manage the risk of price or currency fluctuation with respect to section 1231 property and section 988 transactions. Thus, §1.446-4 does not explicitly apply to all bona fide hedging transactions, which has led to some uncertainty about whether gain or loss from a bona fide hedging transaction that is not described in §1.1221-2(b) is properly taken into account in the same taxable year as gain or loss on the hedged item. The Department of the Treasury (Treasury Department) and the IRS understand that some taxpayers have applied the hedge timing rules of §1.446-4 to all bona fide hedging transactions, irrespective of whether those transactions are hedging transactions as defined in §1.1221-2(b).

2. Treasury center CFCs

It is common for a U.S.-parented multinational group to own one or more CFCs that serve as financing entities for other group members. Such CFCs (treasury center

CFCs) may borrow in various currencies from third party lenders or from other members of the group and lend the proceeds to other members of the group. Treasury center CFCs also may be used to centralize the management of currency and other risks of other CFCs within the multinational group. Treasury center CFCs typically qualify as securities dealers under section 475, but if a treasury center CFC transacts primarily or exclusively with related persons, as is often the case, it would not qualify as a regular dealer under §1.954-2(a)(4)(iv) and thus would not be eligible for the special rules applying the business needs exclusion to certain transactions of regular dealers under §1.954-2(g)(2)(ii)(C).

When a treasury center CFC borrows nonfunctional currency from related or unrelated parties and makes loans denominated in that nonfunctional currency to a related CFC, the foreign currency gain or loss attributable to the principal amount borrowed by the treasury center CFC will economically offset all or a portion of the foreign currency loss or gain, respectively, attributable to the lending activity. Similarly, the foreign currency gain or loss attributable to the treasury center CFC's accrual of interest income and expense with respect to its lending and borrowing activities, respectively, will offset each other, in whole or in part. Thus, by borrowing and lending in the same nonfunctional currency, a treasury center CFC is said to be "naturally hedged."

Although foreign currency gain and loss attributable to lending and borrowing transactions that are denominated in the same nonfunctional currency will typically partially or fully economically offset, the applicable tax accounting methods may cause the treasury center CFC to recognize a gain and an offsetting loss in different taxable

years. If a treasury center CFC qualifies as a dealer under section 475, for example because it regularly purchases debt from related CFCs in the ordinary course of a trade or business, the treasury center CFC generally must use a mark-to-market method of accounting for its securities. See section 475 and §1.475(c)-1(a)(3)(i). However, §1.475(c)-2(a)(2) provides that a dealer's own issued debt liabilities are not securities for purposes of section 475. Thus, a treasury center CFC that funds its nonfunctional currency lending activities in whole or in part by issuing matching nonfunctional currency debt must mark to market its loan receivables and generally will include any foreign currency gain or loss recognized as a result of the mark to market in the computation of FPHCI each year, but, pursuant to §1.475(c)-2(a)(2), offsetting foreign currency loss or gain, respectively, on its borrowing transactions generally is not taken into account until principal and interest is paid. Moreover, the rule in §1.1221-2(d)(5) prohibits taxpayers from treating the purchase or sale of a debt instrument as a hedging transaction, which will generally prevent a treasury center CFC from relying on the §1.446-4 hedge timing rules to match foreign currency gains and losses on borrowing transactions and loan receivables. The resulting mismatch in the timing of offsetting foreign currency gains and losses may have significant adverse consequences on the computation of the treasury center CFC's subpart F income because, as discussed in Part A.2 of this Background section, a foreign currency loss generally will not reduce the CFC's subpart F income except to the extent there are other foreign currency gains in the year the loss is recognized. Treasury and the IRS understand that some taxpayers have taken the position that the offsetting foreign currency gains and losses on the

naturally hedged nonfunctional currency loans and borrowings may be taken into account in the same taxable years.

C. Foreign Currency Gain or Loss on Interest-Bearing Liabilities and Related Hedging Transactions

As explained in Part A.3 of this Background section, the business needs exclusion does not apply to foreign currency gain or loss with respect to a transaction or property if any subpart F income arises, or could reasonably be expected to arise, from the transaction or property. §1.954-2(g)(2)(ii)(B)(2). However, §1.954-2(g)(2)(iii) provides a special rule for foreign currency gain or loss arising from an interest-bearing liability. Under §1.954-2(g)(2)(iii), such foreign currency gain or loss generally is characterized as subpart F income and non-subpart F income in the same manner that interest expense associated with the liability would be allocated and apportioned between subpart F income and non-subpart F income under §§1.861-9T and 1.861-12T. Section 1.954-2(g) does not provide a corresponding rule for a bona fide hedging transaction with respect to an interest-bearing liability. However, §1.861-9T(b)(2) and (b)(6) provide rules that allocate foreign currency gain or loss on certain hedging transactions in the same manner as interest expense. A foreign currency gain or loss arising from a transaction that hedges an interest-bearing liability and that is not governed by §1.861-9T is subject to the general rule of §1.954-2(g)(2)(ii)(B)(2) and its "cliff effect." Consequently, although the foreign currency gain or loss on the hedge of an interest-bearing liability economically offsets the foreign currency loss or gain on that liability, the interaction of the regulations under sections 861 and 954 could result in different allocations of foreign currency gains and losses between subpart F income and non-subpart F income.

D. Elections to Treat Foreign Currency Gain or Loss as a Specific Category of Subpart F Income or FBCI or FPHCI

Section 1.954-2 provides two elections with respect to foreign currency gains or losses. Under the first election, the controlling United States shareholders of a CFC may elect to include foreign currency gain or loss that relates to a specific category of subpart F income or, in the case of FBCI, a specific subcategory of FBCI described in §1.954-1(c)(1)(iii)(A)(1) or (2), in that category of subpart F income or FBCI, rather than in FPHCI. See §1.954-2(g)(3). Thus, for example, under this election, foreign currency gain or loss on a transaction that hedges currency risk with respect to transactions that result in foreign base company sales income would be included in the foreign base company sales income category for purposes of determining subpart F income. This election associates foreign currency gain or loss that otherwise would be included in the computation of FPHCI with the categories of subpart F income and foreign base company income to which it relates and allows net foreign currency losses with respect to a category to reduce the income in that category. For this treatment to apply, however, the relationship between the foreign currency gain or loss and the category of income must be clearly determinable from the CFC's records. See §1.954-2(g)(3)(i)(A).

Under the second election, the controlling United States shareholders of a CFC may elect to include in the computation of FPHCI all foreign currency gain or loss attributable to any section 988 transaction (except a transaction in which gain or loss is treated as capital gain or loss under section 988(a)(1)(B)) and to certain section 1256 contracts. See §1.954-2(g)(4). When this election is in effect, net foreign currency loss reduces gross income in other categories of FPHCI. Controlling United States shareholders typically make the §1.954-2(g)(4) election if a CFC has relatively little net

foreign currency gain or loss. In those circumstances, the administrative burden of tracing foreign currency gain and loss to specific transactions or property, as is required under the business needs exclusion and the §1.954-2(g)(3) election, may outweigh the benefit of those provisions. As the CFC's foreign currency gain or loss becomes more significant, the net benefit of the business needs exclusion or the §1.954-2(g)(3) election may increase and the relative benefit of the §1.954-2(g)(4) election may decrease.

Explanation of Provisions

A. Business Needs Exclusion

1. Transactions and property that give rise to both subpart F income and non-subpart F income

The Treasury Department and the IRS believe that foreign currency gain or loss arising from a transaction or property, or from a bona hedging transaction with respect to such a transaction or property, should be eligible for the business needs exclusion to the extent the transaction or property generates non-subpart F income. Accordingly, proposed §1.954-2(g)(2)(ii)(C)(1) provides that foreign currency gain or loss attributable to a transaction or property that gives rise to both subpart F income and non-subpart F income, and that otherwise satisfies the requirements of the business needs exclusion, is allocated between subpart F income and non-subpart F income in the same proportion as the income from the underlying transaction or property. As a result, the amount of foreign currency gain or loss allocable to non-subpart F income qualifies for the business needs exclusion, and the amount allocable to subpart F income is taken into account in computing FPHCI. Under proposed §1.954-2(g)(2)(ii)(C)(1), the entire foreign currency gain or loss arising from property that does not give rise to income (as

defined in §1.954-2(e)(3)), or from a bona fide hedging transaction with respect to such property, is attributable to subpart F income because any gain upon a disposition of such property would be subpart F income.

2. Hedges of net investment in a QBU

The Treasury Department and the IRS believe that a transaction that manages exchange rate risk with respect to a CFC's net investment in a QBU that is not treated as a separate entity for federal income tax purposes should qualify for the business needs exclusion to the extent the underlying property of the QBU does not give rise to subpart F income. Accordingly, proposed §1.954-2(g)(2)(ii)(C)(2) provides that the qualifying portion of any foreign currency gain or loss that arises from a "financial statement hedging transaction" with respect to a QBU and that is allocable to non-subpart F income is directly related to the business needs of a CFC. A financial statement hedging transaction is defined as a transaction that is entered into by a CFC for the purpose of managing exchange rate risk with respect to part or all of that CFC's net investment in a QBU that is included in the consolidated financial statements of a United States shareholder of the CFC or a corporation that directly or indirectly owns such United States shareholder. The qualifying portion is defined as the amount of foreign currency gain or loss arising from a financial statement hedging transaction that is properly accounted for under U.S. GAAP as a cumulative foreign currency translation adjustment to shareholders' equity. The qualifying portion of any foreign currency gain or loss arising from a financial statement hedging transaction must be allocated between subpart F income and non-subpart F income using the principles of §1.987-

6(b). The amount of the qualifying portion allocated to non-subpart F income qualifies for the business needs exclusion.

The proposed amendment to §1.446-4(a), discussed in Part B.1 of this Explanation of Provisions section, provides that a bona fide hedging transaction (as defined in §1.954-2(a)(4)(ii)) is subject to the hedge timing rules of §1.446-4. Additionally, as noted earlier, proposed §1.954-2(g)(2)(ii)(C)(2) provides that part or all of the qualifying portion of any foreign currency gain or loss arising from a financial statement hedging transaction is eligible for the business needs exclusion. However, financial statement hedging transactions are not included in the definition of bona fide hedging transaction under §1.954-2(a)(4)(ii), as proposed to be amended pursuant to these proposed regulations. Thus, foreign currency gain or loss arising from a financial statement hedging transaction is not subject to the hedge timing rules of §1.446-4 and is taken into account in accordance with the taxpayer's method of accounting. Generally, a taxpayer's financial statement hedging transaction is a section 988 transaction with respect to the taxpayer. Accordingly, to the extent that the taxpayer elects to use a mark-to-market method of accounting for section 988 gain or loss under proposed §1.988-7, and also makes the annual deemed termination election described in §1.987-8T(d), the taxpayer generally would recognize annually foreign currency gain or loss from both the financial statement hedging transaction and the QBU with respect to which exchange rate risk is managed. The Treasury Department and the IRS request comments regarding whether the hedge timing rules of §1.446-4 should apply to a financial statement hedging transaction (as defined in proposed §1.954-2(g)(2)(ii)(C)(2)) with respect to section 987 QBUs with respect to which no annual

deemed termination election is in effect, and, if so, how the appropriate matching should be achieved.

The Treasury Department and the IRS also request comments regarding whether the business needs exclusion should apply to a transaction that is entered into for the purpose of managing the risk of foreign currency fluctuation with respect to a CFC's net investment in a subsidiary CFC. Comments are requested regarding how the gain or loss on such a transaction could or should be allocated between subpart F and non-subpart F income and whether and how the gain or loss could or should be matched with the foreign currency gain or loss on the "hedged" item.

The Treasury Department and the IRS are aware that a CFC may enter into a transaction that manages exchange rate risk arising from a disregarded loan to a QBU. The Treasury Department and the IRS understand that, for U.S. GAAP purposes, exchange gain or loss with respect to a transaction that manages exchange rate risk with respect to the disregarded loan generally would not be reflected as a cumulative foreign currency translation adjustment. For federal income tax purposes, the loan would be disregarded, and exchange gain or loss on the hedging transaction potentially could be subpart F income. The Treasury Department and the IRS request comments regarding whether, taking into account the amendments in the proposed regulations, additional amendments to the business needs exclusion are appropriate to account for foreign currency gain or loss arising from a transaction that is entered into for the purpose of managing the risk of foreign currency fluctuation with respect to disregarded transactions, including disregarded loans, between a CFC and its QBU. Specifically, comments are requested regarding how the foreign currency gain or loss on such a

hedging transaction could or should be allocated between subpart F and non-subpart F income and when such foreign currency gain or should be recognized.

B. Timing of Foreign Currency Gains and Losses

1. Extension of §1.446-4 hedge timing rules to bona fide hedging transactions

The proposed amendment to §1.446-4(a) extends the hedge timing rules of §1.446-4 to all bona fide hedging transactions as defined in §1.954-2(a)(4)(ii). Although this amendment will be particularly useful in connection with foreign currency gains and losses from bona fide hedging transactions of treasury center CFCs, the amendment will eliminate timing mismatches for gains and losses arising from all bona fide hedging transactions and from the hedged property or transaction.

In addition, proposed §1.954-2(a)(4)(ii) revises the definition of a bona fide hedging transaction to permit the acquisition of a debt instrument by a CFC to be treated as a bona fide hedging transaction with respect to an interest-bearing liability of the CFC, provided that the acquisition of the debt instrument has the effect of managing the CFC's exchange rate risk with respect to the liability within the meaning of §1.1221-2(c)(4) and (d), determined without regard to §1.1221-2(d)(5), and otherwise meets the requirements of a bona fide hedging transaction. If a CFC, including a treasury center CFC, identifies a debt instrument that manages exchange rate risk as a hedge of an interest-bearing liability, the foreign currency gain or loss arising from that debt instrument will be taken into account under §1.446-4 at the same time as the foreign currency gain or loss arising from the hedged interest-bearing liability.

Treating a debt instrument as a hedge of an interest-bearing liability, rather than treating the interest-bearing liability as a hedge of the debt instrument, is consistent with

the principles underlying § 1.861-9T(b)(2), which allocates and apportions foreign currency gain or losses on a transaction that hedges an interest-bearing liability in the same manner as interest expense with respect to the liability is allocated and apportioned. See part C of this Explanation of Provisions section for further discussion of the impact of this rule on the allocation of foreign currency gain or loss on a debt instrument between subpart F income and non-subpart F income.

2. Elective mark-to-market method of accounting for foreign currency gain and loss

Proposed §1.988-7 permits a taxpayer, including a CFC, to elect to use a mark-to-market method of accounting for section 988 gain or loss with respect to section 988 transactions, including becoming an obligor under an interest-bearing liability. This elective mark-to-market method of accounting takes into account only changes in the value of the section 988 transaction attributable to exchange rate fluctuations and does not take into account changes in value due to other factors, such as changes in market interest rates or the creditworthiness of the borrower. The proposed regulations require appropriate adjustments to be made to prevent section 988 gain or loss taken into account under the mark-to-market method of accounting from being taken into account again under section 988 or another provision of the Code.

This election is available to any taxpayer but is expected to be particularly relevant in the case of a treasury center CFC. A treasury center CFC that uses a mark-to-market method for securities under section 475 and that makes the election under proposed §1.988-7 will be able to match the timing of foreign currency gain or loss with respect to an interest-bearing liability (such as a loan from a related or unrelated party) with economically offsetting foreign currency loss or gain arising from its nonfunctional

currency-denominated assets (such as a receivable from a related party). Whether the corresponding foreign currency gains and losses qualify for the business needs exclusion is determined under the rules of §1.954-2(g)(2), as proposed to be amended pursuant to these proposed regulations. Thus, if the foreign currency gains or losses do not fully offset each other, the difference may increase or decrease the CFC's FPHCI. However, the election under proposed §1.988-7 does not apply to the following: (1) any securities that are marked to market under any other provision; (2) any securities that, pursuant to an election or an identification made by the taxpayer, are excepted from mark-to-market treatment under any other provision; (3) any transactions of a QBU that is subject to section 987; or (4) any section 988 transactions denominated in, or determined by reference to, a hyperinflationary currency.

The election applies for the year in which the election is made and all subsequent taxable years unless it is revoked by the Commissioner or the taxpayer or, in the case of a CFC, the controlling domestic shareholders of the CFC. Proposed §1.988-7(d) permits a taxpayer or CFC to revoke the election to use a mark-to-market method of accounting for foreign currency gains or losses on section 988 transactions at any time. A subsequent election cannot be made until the sixth taxable year following the year of revocation and cannot be revoked until the sixth taxable year following the year of such subsequent election.

C. Hedges of Exchange Rate Risk Arising from an Interest-Bearing Liability

The Treasury Department and the IRS believe that it is appropriate to require foreign currency gain or loss from transactions that have the effect of managing exchange rate risk arising from an interest-bearing liability to be allocated between

subpart F income and non-subpart F income in the same manner as the foreign currency gain or loss on the hedged liability. Accordingly, the proposed amendments to §1.954-2(g)(2)(iii) require foreign currency gains and losses arising from a transaction or property (including debt instruments) that manages exchange rate risk with respect to an interest-bearing liability to be allocated and apportioned between subpart F income and non-subpart F income in the same manner that foreign currency gain or loss from the interest-bearing liability would be allocated and apportioned. As noted in Part B.1 of this Explanation of Provisions, the proposed amendment to §1.954-2(a)(4)(ii) revises the definition of a bona fide hedging transaction to permit the acquisition of a debt instrument by a CFC to be treated as a bona fide hedging transaction with respect to an interest-bearing liability of the CFC under certain circumstances. As a result of that proposed amendment and the amendment described in this Part C, if a CFC identifies a debt instrument that manages exchange rate risk as a hedge of an interest-bearing liability, the foreign currency gain or loss arising from that debt instrument will be allocated between subpart F income and non-subpart F income in the same manner as the foreign currency gain or loss arising from the hedged interest-bearing liability. Thus, the proposed amendments to the regulations permit a CFC that timely and properly identifies a debt instrument as a hedge of an interest-bearing liability to alleviate the character mismatch that may occur under the existing regulations, as described in Part C of the Background section of this preamble. The proposed amendments to §1.954-2(g)(2)(iii) also clarify that the special rules in that paragraph apply to foreign currency gain or loss arising from an interest-bearing liability, or from a bona fide hedging

transaction with respect to the liability, in lieu of the general rule of the business needs exclusion in §1.954-2(g)(2)(ii).

D. Revocation of Election to Treat Foreign Currency Gain or Loss as a Specific Category of Subpart F Income or as FPHCI

Proposed §1.954-2(g)(3)(iii) permits a CFC to revoke its election under §1.954-2(g)(3) (to characterize foreign currency gain or loss that arises from a specific category of subpart F income as gain or loss in that category) at any time without securing the prior consent of the Commissioner. Similarly, proposed §1.954-2(g)(4)(iii) permits a CFC to revoke its election under §1.954-2(g)(4) (to treat all foreign currency gain or loss as FPHCI) at any time without securing the prior consent of the Commissioner. The Treasury Department and the IRS remain concerned about CFCs frequently changing these elections without a substantial business reason but also believe that the ability of a taxpayer to automatically revoke these elections would promote sound tax administration. Therefore, the proposed regulations provide that, if an election has been revoked under proposed §1.954-2(g)(3)(iii) or proposed §1.954-2(g)(4)(iii), a subsequent election cannot be made until the sixth taxable year following the year of revocation and any subsequent election cannot be revoked until the sixth year following the year of such subsequent election.

E. Applicability Dates

The proposed amendments generally are proposed to apply to taxable years ending on or after the date the proposed regulations are published as final regulations in the *Federal Register*. However, the proposed amendments to §§1.446-4(a), 1.954-2(a)(4)(ii)(A), 1.954-2(g)(2)(ii)(C)(1), and 1.954-2(g)(2)(iii) are proposed to apply to bona fide hedging transactions entered into on or after the date the proposed regulations are

published as final regulations in the *Federal Register*. A taxpayer may rely on any of the proposed amendments, other than the amendments to §§1.446-4(a), 1.954-2(a)(4)(ii)(A), 1.954-2(g)(2)(ii)(C)(1), and 1.954-2(g)(2)(iii), insofar as each applies to a bona fide hedging transaction, for taxable years ending on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, provided the taxpayer consistently applies the proposed amendment for all such taxable years that end before the first taxable year ending on or after the date the proposed regulations are published as final regulations in the *Federal Register*. A taxpayer may rely on any of the proposed amendments to §§1.446-4(a), 1.954-2(a)(4)(ii)(A), 1.954-2(g)(2)(ii)(C)(1), and 1.954-2(g)(2)(iii) with respect to a bona fide hedging transaction entered into on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]** and prior to the applicability date, provided the taxpayer consistently applies the proposed amendment to all bona fide hedging transactions entered into on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]** and prior to the date that these regulations are published as final regulations in the *Federal Register*.

Special Analyses

Certain IRS regulations, including these, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It is hereby certified that the collection of information requirement will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations primarily will affect domestic corporations that have foreign operations, which tend to be larger businesses, and that the average burden is minimal.

Accordingly, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f), this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under "ADDRESSES." The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available at www.regulations.gov or upon request. A public hearing will be scheduled if requested in writing by any person that timely submits comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the *Federal Register*.

Drafting Information

The principal author of these regulations is Jeffery G. Mitchell of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.954-2 also issued under 26 U.S.C. 954(b) and (c). * * *

Section 1.988-7 also issued under 26 U.S.C. 446, 988(d), and 989(c). * * *

Par. 2. Section 1.446-4 is amended by:

1. Revising the first sentence of paragraph (a).

2. Revising the heading of paragraph (g) and adding a sentence at the end of paragraph (g).

3. Removing paragraph (h).

The revisions and addition read as follows:

§1.446-4 Hedging transactions.

(a) In general. Except as provided in this paragraph (a), a hedging transaction as defined in §1.1221-2(b) (whether or not the character of gain or loss from the transaction is determined under §1.1221-2) and a bona fide hedging transaction as defined in §1.954-2(a)(4)(ii) must be accounted for under the rules of this section. * * *

* * * * *

(g) Applicability date. * * * This section applies to a bona fide hedging transaction (as defined in §1.954-2(a)(4)(ii)) entered into on or after the date that these regulations are published as final regulations in the *Federal Register*.

Par. 3. Section 1.954-0(b) is amended by:

1. Redesignating the entry for §1.954-2(g)(2)(ii)(D) as the entry for §1.954-2(g)(2)(ii)(E).

2. Redesignating the entries for §1.954-2(g)(2)(ii)(C), (g)(2)(ii)(C)(1), (g)(2)(ii)(C)(2), (g)(2)(ii)(C)(2)(i), (g)(2)(ii)(C)(2)(ii), and (g)(2)(ii)(C)(2)t(iii) as the entries

for §1.954-2(g)(2)(ii)(D), (g)(2)(ii)(D)(1), (g)(2)(ii)(D)(2), (g)(2)(ii)(D)(2)(i), (g)(2)(ii)(D)(2)(ii), and (g)(2)(ii)(D)(2)(iii), respectively.

3. Adding new entries for §1.954-2(g)(2)(ii)(C), (g)(2)(ii)(C)(1), and (g)(2)(ii)(C)(2).

4. Revising the entry for §1.954-2(g)(2)(iii).

The additions and revision read as follows:

§1.954-0 Introduction.

* * * * *

(b) * * *

§1.954-2 Foreign personal holding company income.

* * * * *

(g) * * *

(2) * * *

(ii) * * *

(C) Foreign currency gains and losses arising from a transaction or property that gives rise to both non-subpart F income and subpart F income or from a bona fide hedging transaction with respect to such a transaction or property.

(1) In general.

(2) Financial statement hedging transaction with respect to the net investment in a qualified business unit.

* * * * *

(iii) Special rule for foreign currency gain or loss from an interest-bearing liability and bona fide hedges of an interest-bearing liability.

* * * * *

Par. 4. Section 1.954-2 is amended by:

1. Adding a sentence after the first sentence in paragraph (a)(4)(ii)(A).

2. Redesignating paragraph (g)(2)(ii)(D) as paragraph (g)(2)(ii)(E).

3. Redesignating paragraph (g)(2)(ii)(C) as paragraph (g)(2)(ii)(D).

4. In newly redesignated paragraph (g)(2)(ii)(D)(2)(i), removing “paragraph (g)(2)(ii)(C)” and adding “paragraph (g)(2)(ii)(D)” in its place and removing “paragraph (g)(2)(ii)(C)(1)” and adding “paragraph (g)(2)(ii)(D)(1)” in its place.

5. In newly redesignated paragraph (g)(2)(ii)(D)(2)(ii), removing “paragraph (g)(2)(ii)(C)(2)(i)” and adding “paragraph (g)(2)(ii)(D)(2)(i)” each place it appears.

6. In newly redesignated paragraph (g)(2)(ii)(D)(2)(iii), removing “paragraph (g)(2)(ii)(C)(2)” and adding “paragraph (g)(2)(ii)(D)(2)” in its place.

7. Adding new paragraph (g)(2)(ii)(C).

8. Revising paragraph (g)(2)(iii).

9. Revising paragraph (g)(3)(iii).

10. Revising paragraph (g)(4)(iii).

11. Adding two sentences after the third sentence in paragraph (i)(2).

The additions and revisions read as follows:

§1.954-2 Foreign personal holding company income.

(a) * * *

(4) * * *

(ii) * * *

(A) * * * Additionally, the acquisition of a debt instrument by a controlled foreign corporation may be treated as a bona fide hedging transaction with respect to an interest-bearing liability of the controlled foreign corporation, provided that the acquisition of the debt instrument has the effect of managing the controlled foreign corporation’s exchange rate risk with respect to the liability within the meaning of §1.1221-2(c)(4) and (d), determined without regard to §1.1221-2(d)(5), and otherwise meets the requirements of paragraph (a)(4)(ii) of this section. * * *

* * * * *

(g) * * *

(2) * * *

(ii) * * *

(C) Foreign currency gains and losses arising from a transaction or property that gives rise to both non-subpart F income and subpart F income or from a bona fide hedging transaction with respect to such a transaction or property--(1) In general. If a foreign currency gain or loss would be directly related to the business needs of the controlled foreign corporation pursuant to paragraph (g)(2)(ii)(B)(1) or (2) of this section except that it arises from a transaction or property that gives rise, or is reasonably expected to give rise, to both non-subpart F income and subpart F income (other than foreign currency gain or loss), or from a bona fide hedging transaction with respect to such a transaction or property, the amount of foreign currency gain or loss that is allocable to non-subpart F income under this paragraph (g)(2)(ii)(C)(1) is directly related to the business needs of the controlled foreign corporation. The amount of foreign currency gain or loss arising from a transaction or property described in this paragraph (g)(2)(ii)(C)(1), or from a bona fide hedging transaction with respect to such a transaction or property, that is allocable to non-subpart F income equals the product of the total amount of foreign currency gain or loss arising from the transaction or property and the ratio of non-subpart F income (other than foreign currency gain or loss) that the transaction or property gives rise to, or is reasonably expected to give rise to, to the total income that the transaction or property gives rise to, or is reasonably expected to give rise to. However, none of the foreign currency gain or loss arising from property that does not give rise to income (as defined in paragraph (e)(3) of this section), or from

a bona fide hedging transaction with respect to such property, is allocable to non-subpart F income.

(2) Financial statement hedging transaction with respect to a qualified business unit. If foreign currency gain or loss arises from a financial statement hedging transaction (as defined in this paragraph (g)(2)(ii)(C)(2)) with respect to a qualified business unit (as defined in §1.989(a)-1) (QBU) of a controlled foreign corporation that is not treated as an entity separate from the controlled foreign corporation for federal income tax purposes, either because it is a branch or division of the controlled foreign corporation or because it is a business entity that is disregarded as separate from its owner under §301.7701-3 of this chapter, the amount of the qualifying portion (as determined under this paragraph (g)(2)(ii)(C)(2)) of foreign currency gain or loss that is allocable to non-subpart F income under this paragraph (g)(2)(ii)(C)(2) is directly related to the business needs of the controlled foreign corporation. Generally, the controlled foreign corporation must allocate the qualifying portion of foreign currency gain or loss arising from the financial statement hedging transaction between subpart F income and non-subpart F income in the same proportion as it would characterize gain or loss determined under section 987 as subpart F income and non-subpart F income under the principles of §1.987-6(b). A financial statement hedging transaction is a transaction that is entered into by a CFC for the purpose of managing exchange rate risk with respect to part or all of that CFC's net investment in a QBU that is included in the consolidated financial statements of a United States shareholder of the CFC (or a corporation that directly or indirectly owns such United States shareholder). The qualifying portion of foreign currency gain or loss is the amount of foreign currency gain

or loss arising from a financial statement hedging transaction that is properly accounted for under U.S. generally accepted accounting principles as a cumulative foreign currency translation adjustment to shareholders' equity.

* * * * *

(iii) Special rule for foreign currency gain or loss from an interest-bearing liability and bona fide hedges of an interest-bearing liability. Except as provided in paragraph (g)(2)(ii)(D)(2) or (g)(5)(iv) of this section, foreign currency gain or loss arising from an interest-bearing liability is characterized as subpart F income and non-subpart F income in the same manner that interest expense associated with the liability would be allocated and apportioned between subpart F income and non-subpart F income under §§1.861-9T and 1.861-12T. Likewise, foreign currency gain or loss arising from a bona fide hedging transaction entered into by the controlled foreign corporation that has the effect of managing exchange rate risk with respect to an interest-bearing liability that is not subject to paragraph (g)(2)(ii)(D)(2) (certain interest-bearing liabilities treated as dealer property) or (g)(5)(iv) (gain or loss allocated under §1.861-9) of this section is characterized as subpart F income and non-subpart F income in the same manner that interest expense associated with the interest-bearing liability would be allocated and apportioned between subpart F income and non-subpart F income under §§1.861-9T and 1.861-12T. Paragraph (g)(2)(ii) of this section does not apply to any foreign currency gain or loss described in this paragraph (g)(2)(iii).

(3) * * *

(iii) Revocation of election. This election is effective for the taxable year of the controlled foreign corporation for which it is made and all subsequent taxable years of

such corporation unless revoked by the Commissioner or the controlling United States shareholders (as defined in §1.964-1(c)(5)) of the controlled foreign corporation. The controlling United States shareholders of a controlled foreign corporation may revoke such corporation's election at any time. If an election has been revoked under this paragraph (g)(3)(iii), a new election under paragraph (g)(3) of this section cannot be made until the sixth taxable year following the year in which the previous election was revoked, and such subsequent election cannot be revoked until the sixth taxable year following the year in which the subsequent election was made. The controlling United States shareholders revoke an election on behalf of a controlled foreign corporation by filing a statement that clearly indicates such election has been revoked with their original or amended income tax returns for the taxable year of such United States shareholders ending with or within the taxable year of the controlled foreign corporation for which the election is revoked.

* * * * *

(4) * * *

(iii) Revocation of election. This election is effective for the taxable year of the controlled foreign corporation for which it is made and all subsequent taxable years of such corporation unless revoked by the Commissioner or the controlling United States shareholders (as defined in §1.964-1(c)(5)) of the controlled foreign corporation. The controlling United States shareholders of a controlled foreign corporation may revoke such corporation's election at any time. If an election has been revoked under this paragraph (g)(4)(iii), a new election under paragraph (g)(4) of this section cannot be made until the sixth taxable year following the year in which the previous election was

revoked, and such subsequent election cannot be revoked until the sixth taxable year following the year in which the subsequent election was made. The controlling United States shareholders revoke an election on behalf of a controlled foreign corporation by filing a statement that clearly indicates such election has been revoked with their original or amended income tax returns for the taxable year of such United States shareholders ending with or within the taxable year of the controlled foreign corporation for which the election is revoked.

* * * * *

(i) * * *

(2) Other paragraphs. * * * The second sentence of paragraph (a)(4)(ii)(A), paragraph (g)(2)(ii)(C)(1), and the second sentence of paragraph (g)(2)(iii) apply to a bona fide hedging transaction entered into on or after the date the proposed regulations are published as final regulations in the *Federal Register*. Paragraphs (g)(2)(ii)(C) (other paragraph (g)(2)(ii)(C)(1), insofar as it applies to a bona fide hedging transaction), (g)(3)(iii), and (g)(4)(iii) of this section apply to taxable years of controlled foreign corporations ending on or after the date that these regulations are published as final regulations in the *Federal Register*.

Par. 5. Section 1.988-7 is added to read as follows:

§1.988-7 Election to mark-to-market foreign currency gain or loss on section 988 transactions.

(a) In general. Except as provided in paragraph (b) of this section, a taxpayer may elect under this section to apply the foreign currency mark-to-market method of accounting described in this section with respect to all section 988 transactions (including the acquisition and holding of nonfunctional currency described in section

988(c)(1)(C)(ii)). Under the foreign currency mark-to-market method of accounting, the timing of section 988 gain or loss on section 988 transactions is determined under the principles of section 1256. Only section 988 gain or loss is taken into account under the foreign currency mark-to-market method of accounting. Consistent with section 1256(a)(2), appropriate adjustments must be made to prevent the section 988 gain or loss from being taken into account again under section 988 or another provision of the Code or regulations. A section 988 transaction subject to this election is not subject to the "netting rule" of section 988(b) and §1.988-2(b)(8), under which exchange gain or loss is limited to overall gain or loss realized in a transaction, in taxable years prior to the taxable year in which section 988 gain or loss would be recognized with respect to such section 988 transaction but for this election.

(b) Exceptions. The election described in paragraph (a) of this section does not apply to:

(1) Any security, commodity, or section 1256 contract that is marked to market under any other provision, including section 475 or section 1256;

(2) Any security, commodity, or section 1256 contract that, pursuant to an election or an identification made by the taxpayer, is excepted from mark-to-market treatment under another provision, including section 475 or section 1256;

(3) Any transaction of a qualified business unit (as defined in section 1.989(a)-1(b)) that is subject to section 987; or

(4) Any section 988 transaction denominated in, or determined by reference to, a hyperinflationary currency. See §1.988-2(b)(15), (d)(5), and (e)(7) for rules relating to such transactions.

(c) Time and manner of election. A taxpayer makes the election under paragraph (a) of this section by filing a statement that clearly indicates that such election has been made with the taxpayer's timely-filed original federal income tax return for the taxable year for which the election is made. In the case of a controlled foreign corporation, the controlling United States shareholders (as defined in §1.964-1(c)(5)) make the election under paragraph (a) of this section on behalf of the controlled foreign corporation by filing a statement that clearly indicates that such election has been made with their timely-filed, original federal income tax returns for the taxable year of such United States shareholders ending with or within the taxable year of the controlled foreign corporation for which the election is made.

(d) Revocation and subsequent election. A taxpayer may revoke its election under paragraph (a) of this section at any time. If an election has been revoked under this paragraph (d), a new election under paragraph (a) of this section cannot be made until the sixth taxable year following the year in which the previous election was revoked, and such subsequent election cannot be revoked until the sixth taxable year following the year in which the subsequent election was made. A taxpayer revokes the election by filing a statement that clearly indicates that such election has been revoked with its original or amended federal income tax return for the taxable year for which the election is revoked. In the case of a controlled foreign corporation, the controlling United States shareholders revoke the election on behalf of the controlled foreign corporation by filing a statement that clearly indicates that such election has been revoked with their original or amended federal income tax returns for the taxable year of such United States shareholders ending with or within the taxable year of the controlled

foreign corporation for which the election is revoked.(e) Applicability dates. This section applies to taxable years of taxpayers (including controlled foreign corporations) ending on or after the date these regulations are published as final regulations in the *Federal Register*.

Kirsten Wielobob,

Deputy Commissioner for Services and Enforcement.

BILLING CODE 4830-01-p

[FR Doc. 2017-27320 Filed: 12/18/2017 8:45 am; Publication Date: 12/19/2017]

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Table of Contents

Filed Pursuant to Rule 424(b)(2)
File Number 333-169119

Pricing Supplement to the Prospectus
dated August 31, 2010
and the Prospectus Supplement
dated May 27, 2011

$250,000,000
iPath® GEMS Index™ ETN

The iPath® GEMS Index™ Exchange Traded Notes due February 4, 2038 (the "**Securities**") are linked to the Barclays Global Emerging Markets Strategy (GEMS) Index™ (the "**Index**") and do not guarantee any return of principal at maturity. You will receive periodic interest payments and a cash payment at maturity or upon early redemption based on the performance of the Index less an investor fee. The principal terms of the Securities are as follows:

Issuer: Barclays Bank PLC

Series: Global Medium-Term Notes, Series A

Principal Amount per Security: $50

Inception Date: February 1, 2008.

CUSIP Number: 06739H453

ISIN: US06739H4535

Secondary Market: We have listed the Securities on the NYSE Arca stock exchange ("NYSE Arca") under the ticker symbol JEM. To the extent that an active secondary market in the Securities exists, we expect that investors will purchase and sell the Securities primarily in this secondary market.

Underlying Index

The return on the Securities is linked to the performance of the Index. The Index was created in January 2007 by Barclays Bank PLC (the "**index sponsor**") to provide investors with exposure to local currencies in emerging markets through short-term, liquid and diversified instruments. The Index is intended to replicate a diversified, multi-national money markets strategy by reflecting the total return—including both exchange rate movements and implied local deposit rates—of U.S. dollar investments in the 15 emerging market currencies that the Index comprises (the "**index constituent currencies**"). The index sponsor calculates the level of the Index at approximately 11:00 p.m., London time, on each index business day and publishes it on Bloomberg page BXIIGEM1 as soon as practicable thereafter. In addition to the Index, the index sponsor maintains the Barclays GEMS Spot Index (the "**Spot Index**"). The Spot Index comprises the same index constituent currencies as the Index, but instead of reflecting the total return of U.S. dollar investments in the index constituent currencies, the Spot Index reflects only the exchange rate movements, and not the implied local deposit rates, for such U.S. dollar investments. The level of the Spot Index is used in calculating the interest payments, as described under "The Index—Calculation of the Index" in this pricing supplement.

Payment at Maturity

Payment at Maturity: If you hold your Securities to maturity, you will receive a cash payment per Security equal to the closing indicative value on the final valuation date.

Closing Indicative Value: The closing indicative value on any calendar day will be calculated in the following manner. The closing indicative value on the inception date will equal $50. On each subsequent calendar day until maturity or early redemption, the closing indicative value will equal (1) the closing indicative value on the immediately preceding calendar day (or the ex coupon indicative value if such day was an index roll date) *times* (2) the daily index factor on such calendar day (or, if such day is not an index business day, one) *minus* (3) the investor fee on such calendar day. An "**index business day**" is a day on which (1) it is a business day in London and New York and (2) the Trans-European Automated Real-Time Gross Settlement Express Transfer System ("**TARGET**") is open.

Ex Coupon Indicative Value: The ex coupon indicative value on any index roll date will equal (1) the closing indicative value on such date *minus* (2) the amount of the interest payment per Security that will be paid on the coupon payment date immediately following such date.

Daily Index Factor: The daily index factor on any index business day will equal (1) the closing level of the Index on such index business day *divided by* (2) the closing level of the Index on the immediately preceding index business day.

Investor Fee: The investor fee is equal to 0.89% per year *times* the closing indicative value *times* the daily index factor, calculated on a daily basis in the following manner. The investor fee on the inception date will equal zero. On each subsequent calendar day until maturity or early redemption, the investor fee will be equal to (1) 0.89% *times* (2) the closing indicative value on the immediately preceding calendar day (or the ex coupon indicative value if such day was an index roll date) *times* (3) the daily index factor on that day (or, if such day is not an index business day, one) *divided by* (4) 365.

Because the investor fee reduces the amount of your return at maturity or upon redemption, the level of the Index will need to increase significantly in order for you to receive at least the principal amount of your investment at maturity or upon redemption. If the increase in the level of the Index is insufficient to offset the negative effect of the investor fee, or the level of the Index decreases, you will receive less than the principal amount of your investment at maturity or upon redemption.

Index Roll Date: The index roll date for each month will be the 15th day of such month, beginning on February 15, 2008 and ending on January 15, 2038, or, if any such day is not a business day in all of the relevant cities (which cities are listed under "The Index—Composition of the Index" in this pricing supplement), or TARGET is not open on such day, the next following day that is a business day in all of the relevant cities and on which TARGET is open, in each case as determined by the index sponsor.

Table of Contents

Cover Page, continued

Early Redemption

Early Redemption: Subject to the notification requirements set forth under "Specific Terms of the Securities—Redemption Procedures" in this pricing supplement, you may redeem your Securities on any redemption date during the term of the Securities. If you redeem your Securities, you will receive a cash payment per Security equal to the closing indicative value on the applicable valuation date. You must redeem at least 50,000 Securities at one time in order to exercise your right to redeem your Securities on any redemption date.

Redemption Date: A redemption date is the third business day following each valuation date (other than the final valuation date). The final redemption date will be the third business day following the valuation date that is immediately prior to the final valuation date.

Valuation Date: Valuation date means each business day from February 4, 2008 to January 28, 2038, inclusive or, if such date is not a trading day, the next succeeding trading day, not to exceed five business days. We refer to Thursday, January 28, 2038, as the "**final valuation date**". A "**trading day**" is a day on which (1) it is a business day in all of the relevant cities and TARGET is open, (2) trading is generally conducted on NYSE Arca and (3) trading is generally conducted in the interbank market, in each case as determined by the calculation agent in its sole discretion.

Interest Payments

Interest Payments: On each coupon payment date prior to maturity or early redemption, you will receive an interest payment to reflect the implied interest earned, net of fees, on your Securities from and excluding the index roll date for the immediately preceding month to and including the index roll date for the current month. The amount of the interest payment on any coupon payment date will equal (1) the ex coupon indicative value on the index roll date for the immediately preceding month *times* (2) the *difference between* (a) the monthly IV return and (b) the monthly spot return. The "**monthly IV return**" is the *quotient of* (i) the closing indicative value on the index roll date for the current month *divided by* (ii) the ex coupon indicative value on the index roll date for the immediately preceding month. The "**monthly spot return**" is the *quotient of* (i) the level of the Spot Index on the index roll date for the current month *divided by* (ii) the level of the Spot Index on the index roll date for the immediately preceding month. In no event, however, will the interest payment on any coupon payment date be less than zero. For the purpose of calculating the first interest payment, the index roll date for the immediately preceding month shall be deemed to be the inception date, and the ex coupon indicative value on such date shall be deemed to be equal to the closing indicative value.

Coupon Ex Date: The coupon ex date for each month will be the business day immediately following the index roll date for such month.

Coupon Payment Date: The coupon payment date for each month will be the third business day following the coupon ex date for such month.

Sale to Public: We sold a portion of the Securities on the inception date at 100% of their stated principal amount. The remainder of the Securities will be offered and sold from time to time through Barclays Capital Inc., our affiliate, as agent. Sales of the Securities by us after the inception date will be made at market prices prevailing at the time of sale, at prices related to market prices or at negotiated prices. Barclays Capital Inc. will not receive an agent's commission in connection with sales of the Securities. Please see "Supplemental Plan of Distribution" in this pricing supplement for more information.

We may use this pricing supplement in the initial sale of Securities. In addition, Barclays Capital Inc. or another of our affiliates may use this pricing supplement in market-making transactions in any Securities after their initial sale. ***Unless we or our agent informs you otherwise in the confirmation of sale or in a notice delivered at the same time as the confirmation of sale, this pricing supplement is being used in a market-making transaction.***

The Securities are not deposit liabilities of Barclays Bank PLC and are not insured by the United States Federal Deposit Insurance Corporation or any other governmental agency of the United States, the United Kingdom or any other jurisdiction.

You may lose some or all of your principal if you invest in the Securities. Any payment on the Securities at or prior to maturity is subject to the creditworthiness of Barclays Bank PLC and is not guaranteed by any third party. See "Risk Factors" beginning on page PS-10 of this pricing supplement for risks relating to an investment in the Securities.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined that this pricing supplement is truthful or complete. Any representation to the contrary is a criminal offense.

Patent pending

Pricing Supplement dated August 23, 2012
Issued in denominations of $50

Table of Contents

TABLE OF CONTENTS

PRICING SUPPLEMENT

PROSPECTUS SUPPLEMENT

PROSPECTUS

Table of Contents

PRICING SUPPLEMENT SUMMARY

The following is a summary of terms of the iPath® GEMS Index™ Exchange Traded Notes due February 4, 2038 (the "**Securities**") linked to Barclays Global Emerging Markets Strategy (GEMS) Index™ (the "**Index**"), as well as a discussion of risks and other considerations you should take into account when deciding whether to invest in the Securities. The information in this section is qualified in its entirety by the more detailed explanations set forth elsewhere in this pricing supplement and the accompanying prospectus and prospectus supplement. References to the "prospectus" mean our accompanying prospectus, dated August 31, 2010, and references to the "prospectus supplement" mean our accompanying prospectus supplement, dated May 27, 2011, which supplements the prospectus.

We may, without your consent, create and issue additional securities having the same terms and conditions as the Securities. We may consolidate the additional securities to form a single class with the outstanding Securities.

This section summarizes the following aspects of the Securities:

- What are the Securities and how do they work?
- How do you redeem your Securities?
- What are some of the risks of the Securities?
- Is this the right investment for you?
- What are the tax consequences?

What Are the Securities and How Do They Work?

The Securities are medium-term notes that are uncollateralized debt securities and are linked to the performance of the Index. The Securities will be issued in denominations of $50.

The return on the Securities is linked to the performance of the Index. The Index was created in January 2007 by Barclays Bank PLC (the "**index sponsor**") to provide investors with exposure to local currencies in emerging markets through short-term, liquid and diversified instruments. The Index is intended to replicate a diversified, multi-national money markets strategy by reflecting the total return—including both exchange rate movements and implied local deposit rates—of U.S. dollar investments in the 15 emerging market currencies that the Index comprises (the "**index constituent currencies**"). The index sponsor calculates the level of the Index at approximately 11:00 p.m., London time, on each index business day and publishes it on Bloomberg page BXIIGEM1 as soon as practicable thereafter. In addition to the Index, the index sponsor maintains the Barclays GEMS Spot Index (the "**Spot Index**"). The Spot Index comprises the same index constituent currencies as the Index, but instead of reflecting the total return of U.S. dollar investments in the index constituent currencies, the Spot Index reflects only the exchange rate movements, and not the implied local deposit rates, for such investments. The level of the Spot Index is used in calculating the interest payments, as described under "The Index—Calculation of the Index" in this pricing supplement.

Payment at Maturity or Upon Redemption

If you have not previously redeemed your Securities, you will receive a cash payment per Security equal to the closing indicative value on the final valuation date. Prior to maturity, you may, subject to certain restrictions, redeem your Securities on any redemption date during the term of the Securities, provided that you present at least 50,000 Securities for redemption, or your broker or other financial intermediary (such as a bank or other financial institution not required to register as a broker-dealer to engage in securities transactions) bundles your Securities for redemption with those of other investors to reach this minimum. If you choose to redeem your Securities on a redemption date, you will receive a cash payment per Security equal to the closing indicative value on the applicable valuation date.

The "**closing indicative value**" on any calendar day will be calculated in the following manner. The closing indicative value on the inception date will equal $50. On each subsequent calendar day until maturity or early redemption, the closing indicative value will equal (1) the closing indicative value on the immediately preceding calendar day (or the ex coupon indicative value if such day was an index roll date) *times* (2) the daily index factor on such calendar day (or if such day is not an index business day, one) *minus* (3) the investor fee on such calendar day.

The "**ex coupon indicative value**" on any index roll date will equal (1) the closing indicative value on such date *minus* (2) the amount of the interest payment per Security that will be paid on the coupon payment date immediately following such date.

Table of Contents

An "**index roll date**" is the 15th day of each month, beginning on February 15, 2008 and ending on January 15, 2038, or, if any such day is not a business day in all of the relevant cities (which cities are listed under "The Index—Composition of the Index" in this pricing supplement), or the Trans-European Automated Real-Time Gross Settlement Express Transfer System ("**TARGET**") is not open on such day, the next following day that is a business day in all of the relevant cities and on which TARGET is open, in each case as determined by the index sponsor.

The "**relevant cities**" are Bangkok, Bogotá, Budapest, Buenos Aires, Istanbul, Jakarta, Johannesburg, London, Manila, Mexico City, Moscow, Mumbai, New York, Rio de Janeiro, Santiago de Chile, Seoul and Warsaw.

The "**daily index factor**" on any index business day will equal (1) the closing level of the Index on such index business day *divided by* (2) the closing level of the Index on the immediately preceding index business day.

The "**investor fee**" is equal to 0.89% per year *times* the closing indicative value *times* the daily index factor, calculated on a daily basis in the following manner. The investor fee on the inception date will equal zero. On each subsequent calendar day until maturity or early redemption, the investor fee will be equal to (1) 0.89% *times* (2) the closing indicative value on the immediately preceding calendar day (or the ex coupon indicative value if such day was an index roll date) *times* (3) the daily index factor on that day (or, if such day is not an index business day, one) *divided by* (4) 365.

Because the investor fee reduces the amount of your return at maturity or upon redemption, the level of the Index will need to increase significantly in order for you to receive at least the principal amount of your investment at maturity or upon redemption. If the increase in the level of the Index is insufficient to offset the negative effect of the investor fee, or the level of the Index decreases, you will receive less than the principal amount of your investment at maturity or upon redemption.

A "**trading day**" is a day on which (1) it is a business day in all of the relevant cities and TARGET is open, (2) trading is generally conducted on NYSE Arca and (3) trading is generally conducted in the interbank market, in each case as determined by the calculation agent in its sole discretion.

An "**index business day**" is a day on which (1) it is a business day in London and New York and (2) TARGET is open.

"**Valuation date**" means each business day from February 4, 2008 to January 28, 2038, inclusive or, if such date is not a trading day, the next succeeding trading day, not to exceed five business days. We refer to Thursday, January 28, 2038, as the "**final valuation date**".

A "**redemption date**" is the third business day following each valuation date (other than the final valuation date). The final redemption date will be the third business day following the valuation date that is immediately prior to the final valuation date.

For a further description of how your payment at maturity or redemption will be calculated, see "Hypothetical Examples" and "Specific Terms of the Securities" in this pricing supplement.

Interest Payments

On each coupon payment date prior to maturity or early redemption, you will receive an interest payment to reflect the implied interest earned, net of fees, on your Securities from and excluding the index roll date for the immediately preceding month to and including the index roll date for the current month. The amount of the interest payment on any coupon payment date will equal (1) the ex coupon indicative value on the index roll date for the immediately preceding month *times* (2) the *difference between* (a) the monthly IV return and (b) the monthly spot return. For the purpose of calculating the first interest payment, the index roll date for the immediately preceding month shall be deemed to be the inception date, and the ex coupon indicative value on such date shall be deemed to be equal to the closing indicative value.

The "**coupon payment date**" for each month will be the third business day following the coupon ex date for such month.

The "**coupon ex date**" for each month will be the business day immediately following the index roll date for such month.

The "**monthly IV return**" is the *quotient of* (i) the closing indicative value on the index roll date for the current month *divided by* (ii) the ex coupon indicative value on the index roll date for the immediately preceding month.

Table of Contents

The "**monthly spot return**" is the *quotient of* (i) the level of the Spot Index on the index roll date for the current month *divided by* (ii) the level of the Spot Index on the index roll date for the immediately preceding month. In no event, however, will the interest payment on any coupon payment date be less than zero.

For a further description of how interest payments will be calculated, see "Specific Terms of the Securities" in this pricing supplement.

How Do You Redeem Your Securities?

We have listed the Securities on NYSE Arca under the ticker symbol JEM. To the extent that an active secondary market in the Securities exists, we expect that investors will purchase and sell the Securities primarily in this secondary market.

To redeem your Securities, you must instruct your broker or other person through whom you hold your Securities to take the following steps:

- deliver a notice of redemption, which is attached as Annex A, to us via email by no later than 3:00 p.m., New York City time, on the business day prior to the applicable valuation date. If we receive your notice by the time specified in the preceding sentence, we will respond by sending you a form of confirmation of redemption, which is attached as Annex B;
- deliver the signed confirmation of redemption to us via facsimile in the specified form by 3:00 p.m., New York City time, on the same day. We or our affiliate must acknowledge receipt in order for your confirmation to be effective;
- instruct your DTC custodian to book a delivery vs. payment trade with respect to your Securities on the valuation date at a price equal to the applicable daily redemption value, facing Barclays DTC 5101; and
- cause your DTC custodian to deliver the trade as booked for settlement via DTC at or prior to 10:00 a.m., New York City time, on the applicable redemption date (the third business day following the valuation date).

Different brokerage firms may have different deadlines for accepting instructions from their customers. Accordingly, you should consult the brokerage firm through which you own your interest in the Securities in respect of such deadlines. If we do not receive your notice of redemption by 3:00 p.m., New York City time, or your confirmation of redemption by 3:00 p.m., New York City time, on the business day prior to the applicable valuation date, your notice will not be effective and we will not redeem your Securities on the applicable redemption date. Any redemption instructions for which we (or our affiliate) receive a valid confirmation in accordance with the procedures described above will be irrevocable.

What Are Some of the Risks of the Securities?

An investment in the Securities involves risks. Some of these risks are summarized here, but we urge you to read the more detailed explanation of risks in "Risk Factors" in this pricing supplement.

- **Uncertain Principal Repayment**—If the level of the Index decreases or does not increase sufficiently to offset any negative effect of the investor fee, you may receive less than your original investment in the Securities at maturity or upon redemption.
- **Conflicts of Interest with the Index Sponsor—**Barclays Bank PLC is the index sponsor. The index sponsor is responsible for the composition, calculation and maintenance of the Index and has the discretion in a number of circumstances to make judgments in connection with the composition, calculation and maintenance of the Index. The exercise of this discretion may present the index sponsor with significant conflicts of interest in light of the fact that Barclays Bank PLC is the issuer of the Securities. The index sponsor has no obligation to take the needs of any buyer, seller or holder of the Securities into consideration at any time.
- **Currency Risk**—The return on the Securities is linked to the performance of the Index which, in turn, is linked to the exchange rates between the index constituent currencies and the U.S. dollar (as well as the implied local deposit rates for the index constituent currencies). Currency prices may change unpredictably, affecting the level of the Index and, consequently, the value of your Securities in unforeseeable ways.

Table of Contents

- **A Trading Market for the Securities May Not Exist**—Although we have listed the Securities on NYSE Arca under the ticker symbol JEM, a trading market for your Securities may not exist at any time. Even if there is a secondary market for the Securities, it may not provide enough liquidity to trade or sell your Securities easily. In addition, certain affiliates of Barclays Bank PLC intend to engage in limited purchase and resale transactions. If they do, however, they are not required to do so and may stop at any time. We are not required to maintain any listing of the Securities on any securities exchange.

Is This the Right Investment for You?

The Securities may be a suitable investment for you if:

- You are willing to accept the risk of fluctuations in emerging market currency prices in general and the exchange rates between the index constituent currencies and the U.S. dollar in particular.
- You believe the value of the index constituent currencies (when combined with the implied local deposit rates) relative to the U.S. dollar will increase by an amount sufficient to offset the negative effect of the investor fee during the term of the Securities.
- You seek an investment with a return linked to the performance of the emerging market currencies.
- You do not seek a guaranteed return of principal.

The Securities may not be a suitable investment for you if:

- You are not willing to accept the risk of fluctuations in emerging market currency prices in general and the exchange rates between the index constituent currencies and the U.S. dollar in particular.
- You believe the value of the index constituent currencies (when combined with the implied local deposit rates) relative to the U.S. dollar will not increase by an amount sufficient to offset the negative effect of the investor fee during the term of the Securities.
- You prefer the lower risk and therefore accept the potentially lower returns of fixed income investments with comparable maturities and credit ratings.
- You seek a guaranteed return of principal.

What Are the Tax Consequences?

There is no authority that directly addresses the proper U.S. federal income tax treatment of your Securities and therefore the U.S. federal income tax consequences of your investment in the Securities are highly uncertain. In the opinion of our counsel Sullivan & Cromwell LLP, although your Securities are denominated in U.S. dollars, it would be reasonable to treat the Securities as a contingent foreign currency denominated debt instrument for U.S. federal income tax purposes. Absent a change in law or an administrative or judicial ruling to the contrary, by purchasing the Securities you agree to treat the Securities as such for all U.S. federal income tax purposes. Under the rules applicable to contingent foreign currency denominated debt instruments that are denominated in more than one foreign currency, you are required to accrue interest based on the comparable yield of the “predominant currency” of such instrument. We believe, however, that in light of the particular terms of the Securities, it would be reasonable to take the approach that there is no “predominant currency” for the Securities. Accordingly, while there are no rules that address the proper treatment of your Securities, subject to the exceptions discussed below, it would be reasonable for you to generally include the interest paid on the Securities in your gross income at such time that the interest is accrued.

Notwithstanding the opinion of our counsel, it is possible that the Internal Revenue Service may assert that an alternative treatment is more appropriate. Because of this uncertainty, we urge you to consult your own tax advisor as to the tax consequences of your investment in the Securities. **The tax consequences to a secondary purchaser of the Securities may also differ from those described above.**

For a more complete discussion of the U.S. federal income tax consequences of your investment in the Securities, including possible alternative treatments for the Securities, see “Material U.S. Federal Income Tax Considerations” below.

Table of Contents

Conflicts of Interest

Barclays Capital Inc. is an affiliate of Barclays Bank PLC and, as such, has a "conflict of interest" in this offering within the meaning of NASD Rule 2720, as administered by the Financial Industry Regulatory Authority ("**FINRA**"). Consequently, this offering is being conducted in compliance with the provisions of Rule 2720 (or any successor rule thereto). For more information, please refer to "Plan of Distribution—Conflict of Interest" in the accompanying prospectus supplement.

Table of Contents

Hypothetical Examples

The following examples show how the Securities would perform in hypothetical circumstances. We have included two examples in which the Index has increased by approximately 1500% at maturity, as well as two examples in which the Index has decreased by approximately 2.66% at maturity. These examples highlight the behavior of the investor fee in different circumstances. Because the investor fee is a weighted average measure, the absolute level of the investor fee will be dependent upon the path taken by the Index to arrive at its ending level. The figures in these examples have been rounded for convenience. Figures for year 30 are as of the final valuation date, and given the indicated assumptions, a holder will receive payment at maturity in the indicated amount, according to the indicated formula.

The hypothetical examples in this section do not take into account the effects of applicable taxes. The after-tax return you receive on your Securities will depend on the U.S. tax treatment of your Securities and on your particular circumstances. Accordingly, the after-tax rate of return of your Securities could be different than the after-tax return of a direct investment in the Index components or the Index.

Assumptions:

Yearly Fee	Days	Denomination	Starting Index
0.89%	365	$50.00	250.351

A Year	B Index	C Average Yearly Index Factor	D Yearly Fee	E Investor Fee	F Indicative Value Plus Coupons
A	*B*	*B / Starting Index*	*C × Principal × Investor Fee*	*Running Total of D*	*(Principal × C) – E*
0	250.351	1.00	$0.00	$0.00	$50.00
1	301.105	1.20	$0.54	$0.54	$59.60
2	332.438	1.33	$0.59	$1.13	$65.27
3	385.832	1.54	$0.69	$1.81	$75.25
4	413.037	1.65	$0.73	$2.55	$79.95
5	422.102	1.69	$0.75	$3.30	$81.01
6	467.175	1.87	$0.83	$4.13	$89.18
7	504.615	2.02	$0.90	$5.02	$95.76
8	534.145	2.13	$0.95	$5.97	$100.71
9	577.819	2.31	$1.03	$7.00	$108.40
10	653.741	2.61	$1.16	$8.16	$122.40
11	672.924	2.69	$1.20	$9.36	$125.04
12	700.036	2.80	$1.24	$10.60	$129.21
13	790.290	3.16	$1.40	$12.01	$145.83
14	926.828	3.70	$1.65	$13.65	$171.45
15	945.878	3.78	$1.68	$15.34	$173.57
16	1,031.161	4.12	$1.83	$17.17	$188.77
17	1,237.412	4.94	$2.20	$19.37	$227.77
18	1,340.326	5.35	$2.38	$21.75	$245.94
19	1,631.727	6.52	$2.90	$24.65	$301.24
20	1,842.924	7.36	$3.28	$27.93	$340.14
21	2,209.227	8.82	$3.93	$31.85	$409.37
22	2,373.372	9.48	$4.22	$36.07	$437.94
23	2,433.652	9.72	$4.33	$40.40	$445.65
24	2,533.252	10.12	$4.50	$44.90	$461.04
25	2,644.787	10.56	$4.70	$49.60	$478.61
26	2,902.614	11.59	$5.16	$54.76	$524.95
27	3,163.987	12.64	$5.62	$60.39	$571.52
28	3,271.381	13.07	$5.81	$66.20	$587.16
29	4,359.041	17.41	$7.75	$73.95	$796.64
30	3,999.704	15.98	$7.11	$81.06	$717.76
				Annualized Index Return	**9.68%**
				Annualized ETN Total Return	**9.29%**

Table of Contents

Hypothetical Examples

A Year	B Index	C Average Yearly Index Factor	D Yearly Fee	E Investor Fee	F Indicative Value Plus Coupons
A	*B*	*B / Starting Index*	*C × Principal × Investor Fee*	*Running Total of D*	*(Principal × C) – E*
0	250.351	1.00	$0.00	$0.00	$50.00
1	319.116	1.27	$0.57	$0.57	$63.17
2	462.960	1.85	$0.82	$1.39	$91.07
3	744.107	2.97	$1.32	$2.71	$145.90
4	663.725	2.65	$1.18	$3.89	$128.67
5	1,035.043	4.13	$1.84	$5.73	$200.99
6	1,466.595	5.86	$2.61	$8.34	$284.57
7	1,627.348	6.50	$2.89	$11.23	$313.78
8	2,119.451	8.47	$3.77	$15.00	$408.30
9	2,170.789	8.67	$3.86	$18.86	$414.69
10	2,369.802	9.47	$4.21	$23.07	$450.23
11	2,088.174	8.34	$3.71	$26.78	$390.27
12	1,936.419	7.73	$3.44	$30.22	$356.52
13	2,008.216	8.02	$3.57	$33.79	$367.29
14	2,492.106	9.95	$4.43	$38.22	$459.50
15	2,410.285	9.63	$4.28	$42.51	$438.87
16	2,327.998	9.30	$4.14	$46.65	$418.30
17	2,807.066	11.21	$4.99	$51.64	$508.99
18	2,482.166	9.91	$4.41	$56.05	$439.69
19	2,276.762	9.09	$4.05	$60.09	$394.62
20	2,525.007	10.09	$4.49	$64.58	$439.71
21	2,762.362	11.03	$4.91	$69.49	$482.21
22	2,907.962	11.62	$5.17	$74.66	$506.12
23	3,011.775	12.03	$5.35	$80.01	$521.50
24	2,874.495	11.48	$5.11	$85.12	$488.97
25	2,770.918	11.07	$4.93	$90.05	$463.36
26	3,022.518	12.07	$5.37	$95.42	$508.23
27	2,790.855	11.15	$4.96	$100.38	$457.01
28	2,870.505	11.47	$5.10	$105.49	$467.81
29	3,564.053	14.24	$6.34	$111.82	$599.99
30	3,999.704	15.98	$7.11	$118.93	$679.89
				Annualized Index Return	**9.68%**
				Annualized ETN Total Return	**9.09%**

Table of Contents

Hypothetical Examples

A Year	B Index	C Average Yearly Index Factor	D Yearly Fee	E Investor Fee	F Indicative Value Plus Coupons
A	*B*	*B / Starting Index*	*C × Principal × Investor Fee*	*Running Total of D*	*(Principal × C) – E*
0	250.351	1.00	$0.00	$0.00	$50.00
1	253.584	1.01	$0.45	$0.45	$50.19
2	264.822	1.06	$0.47	$0.92	$51.97
3	256.125	1.02	$0.46	$1.38	$49.78
4	284.468	1.14	$0.51	$1.88	$54.93
5	289.029	1.15	$0.51	$2.40	$55.33
6	280.171	1.12	$0.50	$2.89	$53.06
7	285.555	1.14	$0.51	$3.40	$53.63
8	292.592	1.17	$0.52	$3.92	$54.51
9	301.976	1.21	$0.54	$4.46	$55.85
10	306.992	1.23	$0.55	$5.00	$56.31
11	338.741	1.35	$0.60	$5.61	$62.05
12	346.384	1.38	$0.62	$6.22	$62.96
13	340.884	1.36	$0.61	$6.83	$61.25
14	362.122	1.45	$0.64	$7.47	$64.85
15	347.512	1.39	$0.62	$8.09	$61.32
16	344.320	1.38	$0.61	$8.70	$60.07
17	315.888	1.26	$0.56	$9.26	$53.83
18	333.174	1.33	$0.59	$9.86	$56.69
19	325.620	1.30	$0.58	$10.43	$54.60
20	325.251	1.30	$0.58	$11.01	$53.95
21	339.311	1.36	$0.60	$11.62	$56.15
22	310.622	1.24	$0.55	$12.17	$49.87
23	307.425	1.23	$0.55	$12.71	$48.68
24	260.205	1.04	$0.46	$13.18	$38.79
25	280.332	1.12	$0.50	$13.67	$42.31
26	286.275	1.14	$0.51	$14.18	$42.99
27	274.893	1.10	$0.49	$14.67	$40.23
28	251.992	1.01	$0.45	$15.12	$35.21
29	259.000	1.03	$0.46	$15.58	$36.15
30	243.701	0.97	$0.43	$16.01	$32.66
				Annualized Index Return	**-0.09%**
				Annualized ETN Total Return	**-1.41%**

Table of Contents

Hypothetical Examples

A Year	B Index	C Average Yearly Index Factor	D Yearly Fee	E Investor Fee	F Indicative Value Plus Coupons
A	*B*	*B / Starting Index*	*C × Principal × Investor Fee*	*Running Total of D*	*(Principal × C) – E*
0	250.351	1.00	$0.00	$0.00	$50.00
1	245.585	0.98	$0.44	$0.44	$48.61
2	219.408	0.88	$0.39	$0.83	$42.99
3	191.804	0.77	$0.34	$1.17	$37.14
4	197.191	0.79	$0.35	$1.52	$37.86
5	208.853	0.83	$0.37	$1.89	$39.82
6	267.569	1.07	$0.48	$2.36	$51.07
7	277.218	1.11	$0.49	$2.86	$52.51
8	253.384	1.01	$0.45	$3.31	$47.30
9	276.130	1.10	$0.49	$3.80	$51.35
10	311.628	1.24	$0.55	$4.35	$57.89
11	291.901	1.17	$0.52	$4.87	$53.43
12	271.124	1.08	$0.48	$5.35	$48.80
13	290.512	1.16	$0.52	$5.87	$52.15
14	293.707	1.17	$0.52	$6.39	$52.27
15	284.424	1.14	$0.51	$6.90	$49.91
16	278.786	1.11	$0.50	$7.39	$48.29
17	305.143	1.22	$0.54	$7.94	$53.01
18	309.667	1.24	$0.55	$8.49	$53.36
19	299.884	1.20	$0.53	$9.02	$50.87
20	319.974	1.28	$0.57	$9.59	$54.32
21	350.327	1.40	$0.62	$10.21	$59.76
22	335.312	1.34	$0.60	$10.81	$56.16
23	335.031	1.34	$0.60	$11.40	$55.51
24	348.311	1.39	$0.62	$12.02	$57.54
25	336.102	1.34	$0.60	$12.62	$54.51
26	334.267	1.34	$0.59	$13.21	$53.55
27	336.701	1.34	$0.60	$13.81	$53.43
28	288.994	1.15	$0.51	$14.32	$43.39
29	289.778	1.16	$0.52	$14.84	$43.03
30	243.701	0.97	$0.43	$15.27	$33.40
				Annualized Index Return	**-0.09%**
				Annualized ETN Total Return	**-1.34%**

Table of Contents

RISK FACTORS

The Securities are unsecured promises of Barclays Bank PLC and are not secured debt. The Securities are riskier than ordinary unsecured debt securities. The return on the Securities is linked to the performance of the Index. Investing in the Securities is not equivalent to investing directly in index constituent currencies. See "The Index" in this pricing supplement for more information.

This section describes the most significant risks relating to an investment in the Securities. **We urge you to read the following information about these risks, together with the other information in this pricing supplement and the accompanying prospectus and prospectus supplement, before investing in the Securities.**

You should also consider the tax consequences of investing in the Securities, significant aspects of which are uncertain. See "Material U.S. Federal Income Tax Considerations" in this pricing supplement.

Even If the Level of the Index at Maturity or Upon Redemption Is Greater than It Was on the Inception Date, You May Receive Less than the Principal Amount of Your Securities

Because the investor fee reduces the amount of your return at maturity or upon redemption, the Index will need to increase significantly in order for you to receive at least the principal amount of your investment at maturity or upon redemption. If the increase in the level of the Index is insufficient to offset the negative effect of the investor fee, or the level of the Index decreases, you will receive less than the principal amount of your investment at maturity or upon redemption.

You Will Not Benefit from any Increase in the Index (Except as a Result of Interest Payments) if Such Increase Is Not Reflected in the Index on the Applicable Valuation Date

If the positive effect of any increase in the Index is insufficient to offset the negative effect of the investor fee between the inception date and the applicable valuation date (including the final valuation date), we will pay you less than the principal amount of your Securities at maturity or upon redemption. This will be true even if the level of the Index as of some date or dates prior to the applicable valuation date would have been sufficiently high to offset the negative effect of the investor fee. Although you will receive monthly interest payments that reflect the performance of one component of the Index (the implied local deposit rates on the index constituent currencies) each month, these may not be sufficient to offset the negative effect of the investor fee if the level of the Index has not increased sufficiently as of the applicable valuation date.

As Index Sponsor, Barclays Bank PLC Will Have the Authority to Make Determinations That Could Materially Affect Your Note in Various Ways and Create Conflicts of Interest

Barclays Bank PLC is the index sponsor. The index sponsor is responsible for the composition, calculation and maintenance of the Index. As discussed in "The Index" in this pricing supplement, the index sponsor has the discretion in a number of circumstances to make judgments and take actions in connection with the composition, calculation and maintenance of the Index, and any such judgments or actions may adversely affect the value of the Securities.

The role played by Barclays Bank PLC as index sponsor, and the exercise of the kinds of discretion described above and in "The Index" could present it with significant conflicts of interest in light of the fact that Barclays Bank PLC is the issuer of the Securities. The index sponsor has no obligation to take the needs of any buyer, seller or holder of the Securities into consideration at any time.

There Are Restrictions on the Minimum Number of Securities You May Redeem and on the Dates on Which You May Redeem Them

You must redeem at least 50,000 Securities at one time in order to exercise your right to redeem your Securities on any redemption date. You may only redeem your Securities on a redemption date if we receive a notice of redemption from you by no later than 3:00 p.m., New York City time, and a confirmation of redemption by no later than 3:00 p.m., New York City time, on the business day prior to the applicable valuation date. If we do not receive

Table of Contents

your notice of redemption by 3:00 p.m., New York City time, or your confirmation of redemption by 3:00 p.m., New York City time, on the business day prior to the applicable valuation date, your notice will not be effective and we will not redeem your Securities on the applicable redemption date. Your notice of redemption and confirmation of redemption will not be effective until we confirm receipt. See "Specific Terms of the Securities—Redemption Procedures" in this pricing supplement for more information.

The Market Value of the Securities May Be Influenced by Many Unpredictable Factors

The market value of your Securities may fluctuate between the date you purchase them and the applicable valuation date. You may also sustain a significant loss if you sell the Securities in the secondary market. Several factors, many of which are beyond our control, will influence the market value of the Securities. We expect that generally changes in the exchange rates between the index constituent currencies and the U.S. dollar will affect the market value of the Securities more than any other factors. Other factors that may influence the market value of the Securities include:

- supply and demand for the Securities, including inventory positions with Barclays Capital Inc. or any market maker;
- interest rates (including especially the implied deposit rates for each of the index constituent currencies);
- the volatility of the exchange rates between the index constituent currencies and the U.S. dollar;
- economic, financial, political, regulatory, geographical or judicial events that affect the exchange rates or implied interest rates; or
- the creditworthiness of Barclays Bank PLC.

These factors interrelate in complex ways, and the effect of one factor on the market value of your Securities may offset or enhance the effect of another factor.

The Exchange Rates Between The Index Constituent Currencies and the U.S. Dollar Will be Influenced by Unpredictable Factors

The exchange rates between each index constituent currency and the U.S. dollar are a result of the supply of, and demand for, each currency. Changes in the exchange rates may result from the interactions of many factors including economic, financial, social and political conditions in one or more of the countries in which an index constituent currency is the official currency (each an "**index constituent country**") and in the United States. These conditions include, for example, the overall growth and performance of the economies of index constituent countries and the United States, the trade and current account balance between index constituent countries and the United States, inflation, interest rate levels, the performance of stock markets in index constituent countries and the United States, the stability of the governments and banking systems of index constituent countries and the United States, wars in which index constituent countries or the United States are directly or indirectly involved or that occur anywhere in the world, major natural disasters in index constituent countries or the United States, and other foreseeable and unforeseeable events.

Certain relevant information relating to the index constituent countries may not be as well known or as rapidly or thoroughly reported in the United States as compared to U.S. developments. Prospective purchasers of the Securities should be aware of the possible lack of availability of important information that can affect the value of index constituent currencies in relation to the U.S. dollar and must be prepared to make special efforts to obtain such information on a timely basis.

The Liquidity, Trading Value and Amounts Payable Under the Securities Could be Affected by the Actions of Sovereign Governments, including those of the Index Constituent Countries and the U.S. Government

Exchange rates of most developed and major emerging economies, including the United States and all of the index constituency countries, currently are "floating," meaning that they are permitted to fluctuate in value relative to

Table of Contents

other currencies. However, governments of other nations, from time to time, do not allow their currencies to float freely in response to economic forces. Governments, including those of the index constituent countries and the United States, use a variety of techniques, such as intervention by their central bank or imposition of regulatory controls or taxes, to affect the exchange rates of their respective currencies. Governments may also issue a new currency to replace an existing currency or alter the exchange rate or relative exchange characteristics by devaluation or revaluation of a currency. Thus, a special risk in purchasing the Securities is that their liquidity, trading value and amounts payable could be affected by the actions of the governments of index constituent countries or of the United States which could change or interfere with theretofore freely determined currency valuation, fluctuations in response to other market forces and the movement of currencies across borders. As discussed in "The Index" in this pricing supplement, the index sponsor may make certain adjustments to the composition or methodology for calculating the Index in the event of certain developments affecting any index constituent currency or the U.S. dollar, but the index sponsor is under no obligation to do so. Moreover, in no event will the terms of your Securities be changed as a result of developments affecting any index constituent currency or the U.S. dollar.

Replacement, or Preparatory Steps Towards Replacement, of an Index Constituent Currency with the Euro could Affect the Value of Your Securities

Poland and Hungary are members of the European Union and are required under the terms of their accession to the European Union to replace the Polish zloty and the Hungarian forint, respectively, with the euro as their official currencies. Turkey is currently engaged in negotiations to become a member of the European Union and will likely, as a condition to any possible accession, also be required to adopt the euro as its official currency. As of the date of this pricing supplement, the specific date on which the Hungarian forint and the Polish zloty will be replaced by the euro is not known. Whether and when the Turkish lira will be replaced by the euro depends upon the status of its potential admission to the European Union.

The replacement of a currency with the euro requires that the index constituent country have successfully participated in a preparatory exchange rate mechanism for at least two years in advance of actual euro adoption. Participation in this exchange rate mechanism generally requires that the value of the currency be pegged against the euro at a "central rate" and permitted to fluctuate above or below that rate only within certain standard "fluctuation bands". Ultimate adoption of the euro following this preparatory phase would, in turn, be effected through the conversion of the relevant currency into the euro at a fixed rate. As a result, the replacement of the Polish zloty, Hungarian forint and the Turkish lira by the euro, or preparatory steps towards such replacement, during the term of your Securities may, increase the exposure of the Index to political and economic factors in the European Union through an explicit link to the euro and significantly constrain the possible appreciation of the Index, and consequently your Securities.

The U.S. Federal Tax Consequences of Your Investment in the Securities are Highly Uncertain

There is no authority that directly addresses the proper U.S. federal income tax treatment of your Securities and therefore the U.S. federal income tax consequences of your investment in the Securities are highly uncertain. As a result, the Internal Revenue Service could assert that your Securities should be treated in a manner that is different than described herein and, in such case, the tax consequences to you could differ materially from those described herein. **The tax consequences to a secondary purchaser of the Securities may also differ materially from those described in this disclosure.** Please see the discussion below under the heading "Material U.S. Federal Income Tax Considerations" in this pricing supplement for a more complete discussion of the tax consequences of an investment in the Securities and the potential alternative treatments that may be possible. You should consult your tax advisor as to the possible alternative treatments in respect of the Securities.

Table of Contents

Investing in a Security Linked to an Index Based on Emerging Market Currencies Bears Special Risks

The index constituent countries are all emerging markets. An investment in a security linked to an index of emerging market currencies involves many risks beyond those involved in an investment linked to the currencies of developed markets, including, but not limited to: economic, social, political, financial and military conditions in the emerging markets, including especially political uncertainty and financial instability; the increased likelihood of restrictions on export or currency conversion in the emerging markets; the greater potential for an inflationary environment in the emerging markets; the possibility of nationalization or confiscation of assets; the greater likelihood of regulation by the national, provincial and local governments of the emerging market countries, including the imposition of currency exchange laws and taxes; and less liquidity in emerging market currency markets than in those of developed markets. The currencies of emerging markets may be more volatile than those of developed markets and may be affected by political and economic developments in different ways than developed markets. Moreover, the emerging market economies may differ favorably or unfavorably from developed market economies in a variety of ways, including growth of gross national product, rate of inflation, capital reinvestment, resources and self-sufficiency.

Even Though the Index Constituent Currencies and the U.S. Dollar Are Traded Around-the-Clock, the Securities Will Trade Only During Regular Trading Hours in the United States, if at All

The interbank market for the index constituent currencies and the U.S. dollar is a global, around-the-clock market. We have listed the Securities on NYSE Arca and the Securities trade only during the hours that NYSE Arca is open. To the extent that NYSE Arca is closed while the markets for the index constituent currencies and the U.S. dollar remain open, significant price and rate movements may take place in the underlying foreign exchange markets that will not be reflected immediately in the price of the Securities.

Foreign Exchange Rate Information May Not Be Readily Available

There is no systematic reporting of last-sale information for foreign currencies. Reasonable current bid and offer information is available in certain brokers' offices, in bank foreign currency trading offices, and to others who wish to subscribe for this information, but this information will not necessarily reflect the index constituent currency exchange rates relevant for determining the value of the Securities. The absence of last-sale information and the limited availability of quotations to individual investors may make it difficult for many investors to obtain timely, accurate data about the state of the underlying foreign exchange markets.

Historical Levels of the Index Should Not Be Taken as an Indication of the Future Performance of the Index During the Term of the Securities

It is impossible to predict whether the Index will rise or fall. The actual performance of the Index over the term of the Securities, as well as the amount payable at maturity or upon redemption and on each interest payment date, may bear little relation to the historical level of the Index.

Changes in the Implied Interest Rates Will Affect the Value of Your Securities

Because the Index is calculated, in part, based on the implied local deposit rates for each of the index constituent currencies, changes in such rates will affect the amount payable on your Securities at maturity or upon redemption and on each interest payment date and, therefore, the market value of your Securities. Assuming the exchange rates between the index constituent currencies and the U.S. dollar remain constant, an overall increase in the implied local deposit rates for each of the index constituent currencies will eventually increase the value of your Securities, while a decrease in the implied local deposit rates for each of the index constituent currencies will decrease the value of your Securities. Because the implied local deposit rates for each of the index constituent currencies is an implied deposit rate achievable in offshore markets, the levels of such implied deposit rates could be negative.

Table of Contents

Changes in Our Credit Ratings May Affect the Market Value of Your Securities

Our credit ratings are an assessment of our ability to pay our obligations, including those on the Securities. Consequently, actual or anticipated changes in our credit ratings may affect the market value of your Securities. However, because the return on your Securities is dependent upon certain factors in addition to our ability to pay our obligations on your Securities, an improvement in our credit ratings will not reduce the other investment risks related to your Securities.

Owning the Securities Is Not the Same as Owning the Index Constituent Currencies

The return on your Securities will not reflect the exact return you would realize if you actually purchased each of the index constituent currencies and converted them into U.S. dollars on the applicable valuation date. The exchange rate for the index constituent currencies is calculated relative to the U.S. dollar without taking into consideration the value of the index constituent currencies relative to other currencies or in other markets.

You Will Not Have the Right to Receive Index Constituent Currencies

Your Securities will be paid in U.S. dollars, and you will have no right to receive delivery of index constituent currencies.

There May Not Be an Active Trading Market in the Securities; Sales in the Secondary Market May Result in Significant Losses

Although we have listed the Securities on NYSE Arca, there can be no assurance that a secondary market for the Securities will exist. Even if there is a secondary market for the Securities, it may not provide enough liquidity to trade or sell your Securities easily. Additionally, certain affiliates of Barclays Bank PLC may engage in limited purchase and resale transactions in the Securities, although they are not required to do so. If they decide to engage in such transactions, they may stop at any time. We are not required to maintain any listing of the Securities on any securities exchange.

Trading and Other Transactions by Barclays Bank PLC or Its Affiliates in Instruments Linked to the Index, Index Constituent Currencies, the U.S. Dollar or the Exchange Rate Between an Index Constituent Currency and the U.S. Dollar May Impair the Market Value of the Securities

As described below under “Use of Proceeds and Hedging” in this pricing supplement, we or one or more of our affiliates may hedge our obligations under the Securities by purchasing index constituent currencies or U.S. dollars, futures or options on the Index, index constituent currencies, U.S. dollars or the exchange rate between index constituent currencies and the U.S. dollar, or other derivative instruments with returns linked to the performance of the Index, index constituent currencies, U.S. dollars or the exchange rate between index constituent currencies the U.S. dollar, and we may adjust these hedges by, among other things, purchasing or selling any of the foregoing. Although they are not expected to, any of these hedging activities may adversely affect the market price of index constituent currencies, U.S. dollars or the exchange rate between index constituent currencies and the U.S. dollar and, therefore, the market value of the Securities. It is possible that we or one or more of our affiliates could receive substantial returns from these hedging activities while the market value of the Securities declines.

We or one or more of our affiliates may also engage in trading in index constituent currencies or U.S. dollars, futures or options on the Index, index constituent currencies, U.S. dollars or the exchange rate between index constituent currencies and the U.S. dollar, and other investments relating to the Index, index constituent currencies, U.S. dollars or the exchange rate between index constituent currencies and the U.S. dollar on a regular basis as part of our general broker-dealer and other businesses, for proprietary accounts, for other accounts under management or to facilitate transactions for customers. Any of these activities could adversely affect the market price of index constituent currencies, U.S. dollars or the exchange rate between index constituent currencies and the U.S. dollar and, therefore, the market value of the Securities. We or one or more of our affiliates may also issue or underwrite other securities or financial or

Table of Contents

derivative instruments with returns linked or related to changes in the performance of any of the foregoing. By introducing competing products into the marketplace in this manner, we or one or more of our affiliates could adversely affect the market value of the Securities. With respect to any of the activities described above, neither Barclays Bank PLC nor its affiliates has any obligation to take the needs of any buyer, seller or holder of the Securities into consideration at any time.

The Liquidity of the Market for the Securities May Vary Materially Over Time

As stated on the cover of this pricing supplement, we sold a portion of the Securities on the inception date, and the remainder of the Securities will be offered and sold from time to time through Barclays Capital Inc., our affiliate, as agent. Also, the number of Securities outstanding or held by persons other than our affiliates could be reduced at any time due to early redemptions of the Securities. Accordingly, the liquidity of the market for the Securities could vary materially over the term of the Securities. While you may elect to redeem your Securities prior to maturity, early redemption is subject to the conditions and procedures described elsewhere in this pricing supplement, including the condition that you must redeem at least 50,000 Securities at one time in order to exercise your right to redeem your Securities on any redemption date.

The Policies of the Index Sponsor and Changes That Affect the Index Methodology, Index Constituent Currencies or Denominating Currency Could Affect the Amount Payable on the Securities and Their Market Value

The policies of the index sponsor, which is a division of Barclays Bank PLC, concerning the calculation of the level of the Index and any addition, deletion or substitution of index constituent currencies or the denominating currency could affect the value of the Index and, therefore, the amount payable on the Securities at maturity or upon redemption and the market value of the Securities prior to maturity.

The index sponsor may modify the methodology for calculating the value of the Index. In addition, as described in “The Index—Modifications to the Index” in this pricing supplement, under a number of circumstances the index sponsor may replace one or more index constituent currencies, redenominate the Index with a currency other than the U.S. dollar or make certain other changes to the way in which the Index is calculated. The index sponsor may also discontinue or suspend calculation or publication of the Index, in which case it may become difficult to determine the market value of the Index. Any such changes could adversely affect the value of your Securities.

If events such as these occur, or if the value of the Index is not available or cannot be calculated because of a market disruption event or force majeure event, or for any other reason, the calculation agent may be required to make a good faith estimate in its sole discretion of the value of the Index. The circumstances in which the calculation agent will be required to make such a determination are described more fully under “Specific Terms of the Securities—Discontinuation or Modification of the Index” and “—Role of Calculation Agent”.

Our Business Activities May Create Conflicts of Interest

In addition to the role of Barclays Bank PLC as index sponsor as described under “—As Index Sponsor, Barclays Bank PLC Will Have the Authority to Make Determinations That Could Materially Affect Your Note in Various Ways and Create Conflicts of Interest”, we and our affiliates expect to play a variety of roles in connection with the issuance of the Securities.

As noted above, we and our affiliates expect to engage in trading activities related to index constituent currencies and the U.S. dollar, futures or options on the Index, index constituent currencies, U.S. dollars or the exchange rate between index constituent currencies and the U.S. dollar, or other derivative instruments with returns linked to the performance of the Index, index constituent currencies, U.S. dollars or the exchange rate between index constituent currencies and the U.S. dollar that are not for the account of holders of the Securities or on their behalf. These trading activities may present a conflict between the holders’ interest in the Securities and the interests that we and our affiliates will have in our and our affiliates’

Table of Contents

proprietary accounts, in facilitating transactions, including options and other derivatives transactions, for our and our affiliates' customers and in accounts under our and our affiliates' management. These trading activities, if they influence the level of the Index or the exchange rate between index constituent currencies and the U.S. dollar, could be adverse to the interests of the holders of the Securities.

Moreover, we and our affiliates have published and in the future expect to publish research reports with respect to the exchange rate between index constituent currencies and the U.S. dollar and currencies generally. This research is modified from time to time without notice and may express opinions or provide recommendations that are inconsistent with purchasing or holding the Securities. The research should not be viewed as a recommendation or endorsement of the Securities in any way and investors must make their own independent investigation of the merits of this investment.

Any of these activities by us or our affiliates may affect the market price of index constituent currencies, U.S. dollars or the exchange rate between index constituent currencies and the U.S. dollar and, therefore, the market value of the Securities. With respect to any of the activities described above, neither Barclays Bank PLC nor its affiliates has any obligation to take the needs of any buyer, seller or holder of the Securities into consideration at any time.

There Are Potential Conflicts of Interest Between You and the Calculation Agent

Currently, Barclays Bank PLC serves as the calculation agent. We will, among other things, decide the amount of the return paid out to you on the Securities at maturity or upon redemption. For a more detailed description of the calculation agent's role, see "Specific Terms of the Securities—Role of Calculation Agent" in this pricing supplement.

If the index sponsor were to discontinue or suspend calculation or publication of the Index, it may become difficult to determine the market value of the Securities. If events such as these occur, or if the value of the Index is not available or cannot be calculated because of a market disruption event or force majeure event, or for any other reason, the calculation agent may be required to make a good faith estimate in its sole discretion of the value of the Index. The circumstances in which the calculation agent will be required to make such a determination are described more fully under "Specific Terms of the Securities—Role of Calculation Agent" in this pricing supplement.

The calculation agent will exercise its judgment when performing its functions. For example, the calculation agent may have to determine whether a market disruption event or force majeure event affecting the Index has occurred or is continuing on a valuation date, including the final valuation date. This determination may, in turn, depend on the calculation agent's judgment as to whether the event has materially interfered with our ability to unwind our or our affiliates' hedge positions. Since these determinations by the calculation agent may affect the market value of the Securities, the calculation agent may have a conflict of interest if it needs to make any such decision.

THE INDEX

We have derived the following description of the Index from the "Rules for the Management of the GEMS™ (Barclays) Index™", which governs the management and calculation of the Index and is published by the index sponsor, a division of Barclays Bank PLC. We have also derived certain information about the Index from public sources without independent verification.

The Index was created in January 2007 by the index sponsor to provide investors with exposure to local currencies in emerging markets through short-term, liquid and diversified instruments. The index is intended to replicate a diversified, multi-national money markets strategy by reflecting the total return—including both exchange rate movements and implied local deposit rates—of U.S. dollar investments in the index constituent currencies.

Composition of the Index

The 15 index constituent currencies are divided into three regional sub-indices for purposes of calculating the Index (as described further in "—Calculation of the Index"):

- Eastern Europe, Middle East and Africa, which includes the Hungarian forint, the Polish zloty, the Russian ruble, the South African rand and the Turkish lira;

Table of Contents

- Latin America, which includes the Argentine peso, the Brazilian real, the Chilean peso, the Colombian peso and the Mexican peso; and
- Asia, which includes the Indian rupee, the Indonesian rupiah, the Philippine peso, the South Korean won and the Thai baht.

The Index includes a specified amount of each index constituent currency (i.e., a certain number of Russian rubles, a certain number of Colombian pesos, etc.). On the index commencement date, each index constituent currency was weighted equally in U.S. dollar terms, so the amount of any index constituent currency included in the Index was worth the same amount of U.S. dollars as the amount of any other index constituent currency included in the Index. On each index reconstitution date, the index constituent currencies are re-weighted so that as of such date, each index constituent currency is again weighted equally in U.S. dollar terms. During the period between index reconstitution dates, the actual weight of each of the index constituent currencies may fluctuate due to the performance of the individual index constituent currencies.

The "**index commencement date**" was July 16, 2001 (although the Index was created in January 2007, it is calculated as if it had commenced on July 16, 2001).

An "**index reconstitution date**" is the index roll date that falls in July of each year.

An "**index roll date**" is the 15th day of each month, beginning on February 15, 2008 and ending on January 15, 2038, or, if any such day is not a business day in all of the relevant cities or TARGET is not open on such day, the next following day that is a business day in all of the relevant cities and on which TARGET is open, in each case as determined by the index sponsor.

The "**relevant cities**" are Bangkok, Bogotá, Budapest, Buenos Aires, Istanbul, Jakarta, Johannesburg, London, Manila, Mexico City, Moscow, Mumbai, New York, Rio de Janeiro, Santiago de Chile, Seoul and Warsaw.

Calculation of the Index

The level of the Index on each index business day is calculated in the following manner.

Calculation of the Regional Sub-Indices

First, the level of each regional sub-index is calculated by multiplying (1) the level of the sub-index on the most recent index reconstitution date *times* (2) 1/5 *times* (3) the *sum* of the *quotients* of (a) the local currency deposit value of each index constituent currency on the date of calculation *divided by* (b) the local currency deposit value of each such index constituent currency on the most recent index reconstitution date. The level of each regional sub-index will be rounded to four decimal points. On the index commencement date, the level of each regional sub-index was 100.

The "**local currency deposit value**" on any given index business day equals (1) the local currency deposit value on the most recent index roll date *times* (2) the interest rate component *times* (3) the spot component. The local currency deposit value on the index commencement date was 100.

The "**interest rate component**" for any given index constituent currency on any given index business day equals the *quotient* of (1) one *plus* the *product* of (a) the implied local deposit rate for that index constituent currency (from the date that is two index business days after the most recent index roll date to the date that is two index business days after the immediately forthcoming index roll date) *times* (b) the relevant day count fraction *divided by* (2) one *plus* the *product* of (a) the implied local deposit rate for that index constituent currency (from the date that is two index business days after the date of calculation to the date that is two index business days after the immediately forthcoming index roll date) *times* (b) the relevant day count fraction.

The "**implied local deposit rate**" for the period from the date that is two index business days after a given date of calculation to the date that is two index business days after the immediately forthcoming index roll date for any given index constituent currency equals the *quotient* of (1) the *product* of (a) the non-deliverable forward fixing for that currency against one U.S. dollar that is entered into on the date of calculation for fixing on the immediately forthcoming index roll

Table of Contents

date (and for settlement two index business days thereafter), *times* (b) one *plus* the *product* of (i) the LIBOR rate effective from the date that is two index business days after the date of calculation to the date that is two index business days after the immediately forthcoming index roll date, as published on Bloomberg page BBAM1 at 11:00 am, London time, (using linear interpolation where necessary), *times* (ii) the relevant day count fraction, *minus* (c) the spot level of the index constituent currency on the date of calculation, *divided by* (2) the *product* of (a) the spot level of the index constituent currency on that date of calculation, *times* (b) the relevant day count fraction.

The "**day count fraction**" for a given interest rate component or implied local deposit rate is equal to the actual number of days for the period for which such rate is applicable *divided by* 360.

The "**spot component**" for any index constituent currency on any given day is equal to (1) the spot level of the index constituent currency on the most recent index roll date *divided by* (2) the spot level of the index constituent currency on the date of calculation.

The "**spot level**" of each index constituent currency on a given date of calculation is the mid-market rate of such currency, as determined by the index sponsor from the following sources or any successor pages thereto on such date:

Currency	Source (Time)
Argentine peso:	http://www.emta.org (1:30 pm local time)
Brazilian real:	Reuters page BRFR (5:30 pm local time)
Chilean peso:	Reuters page CLPOB= (6:30 pm local time)
Colombian peso:	Reuters page CO/COL03 (6:30 pm local time)
Hungarian forint:	WMCO/Reuters (11:35 am London time)
Indian rupee:	Reuters page RBIB (12:30 pm Mumbai time)
Indonesian rupiah:	Reuters page ABSIRFIX01 (11:30 am Singapore time)
Mexican peso:	WMCO/Reuters (4:35 pm London time)
Philippine peso:	Reuters page PHPFIX=PDSP (11:30 am Singapore time)
Polish zloty:	WMCO/Reuters (11:35 am London time)
Russian ruble:	Reuters page EMTA (10:00 am London time)
South African rand:	WMCO/Reuters (11:35 am London time)
South Korean won:	Reuters page KFTC18 (3:00 pm Singapore time)
Thai baht:	Reuters page ABSIRFIX01 (11:30 am Singapore time)
Turkish lira:	WMCO/Reuters (11:35 am London time)

In the event that any of the foregoing sources becomes unavailable, the index sponsor may use any successor page thereto or alternative source to determine the applicable currency's spot level.

The "**non-deliverable forward fixing**" for each index constituent currency on any given date of calculation equals the *sum* of the spot level on that date of calculation *plus* the applicable interpolated forward points. The index sponsor determines the applicable interpolated forward points by reference to the following sources or any successor pages thereto for forward points (i.e. the difference between the price of the forward and the current exchange rate) and outright forward quotes:

Currency	Source (Time)
*Argentine peso:	WMCO/Reuters (4:35 pm London time)
*Brazilian real:	Reuters page PYEB (4:00 pm London time)
*Chilean peso:	WMCO/Reuters (4:35 pm London time)

Table of Contents

Currency	Source (Time)
*Colombian peso:	WMCO/Reuters (4:35 pm local time)
Hungarian forint:	Reuters Page PYND1 (11:00 am London time)
*Indian rupee:	Reuters page NDF01 (5:15 pm Singapore time)
*Indonesian rupiah:	Reuters page NDF02 (5:15 pm Singapore time)
Mexican peso:	WMCO/Reuters (4:35 pm London time)
*Philippine peso:	Reuters page NDF01 (5:15 pm Singapore time)
Polish zloty:	Reuters page PYND1 (11:00 am London time)
Russian ruble:	Reuters page GFIR (9:30 am London time)
South African rand:	Reuters page FCMF (11:00 am London time)
*South Korean won:	Reuters page NDF01 (5:15 pm Singapore time)
*Thai baht:	Reuters page BGCRF (5:15 pm Singapore time)
Turkish lira:	Reuters page ICAPTRY (11:00 am London time)

In the event that any of the foregoing sources becomes unavailable, the index sponsor may use any successor page thereto or alternative source to determine the applicable currency's interpolated forward points.

With respect to those sources in the table that provide quotes in forward points, the index sponsor determines the applicable interpolated forward points using linear interpolation from the forward points quoted for one week's, two weeks', one month's and two months' tenor.

For all other sources, where the price of the forward is quoted outright, the index sponsor first calculates forward points for one week's, two weeks', one month's and two months' tenor by subtracting the relevant spot level from the outright forward level for such tenors, prior to determining applicable interpolated forward points using linear interpolation in the manner described above.

With respect to currencies that trade in non-deliverable forward markets (which are indicated with an asterisk in the above table), forward points will be calculated from the sources published on the date that is one index business day prior to the date of calculation. If such date is not a business day in the relevant index constituent country, the forward points will be calculated from the source published on the date of calculation.

Calculation of the Index

Once the level of each regional sub-index has been calculated as described above, the level of the Index is then calculated by multiplying (1) the level of the Index on the most recent index reconstitution date *times* (2) 1/3 *times* (3) the *sum* of the *quotients* of (a) the level of each regional sub-index on the date of calculation *divided by* (b) the level of that regional sub-index on the most recent index reconstitution date. The level of the Index will be rounded to four decimal points. The level of the Index on the index commencement date was 100.

The index sponsor calculates the level of the Index at approximately 11:00 p.m., London time, on each index business day and publishes it on Bloomberg page BXIIGEM1 as soon as practicable thereafter.

Calculation of the Spot Index

In addition to the Index, the index sponsor maintains the Barclays GEMS Spot Index (the "**Spot Index**"). The Spot Index comprises the same index constituent currencies as the Index, but instead of reflecting the total return of U.S. dollar investments in the index constituent currencies, the Spot Index reflects only the exchange rate movements, and not the implied local deposit rates, for such investments. The level of the Spot Index is used in calculating the interest payments on your Securities, as discussed in "Specific Terms of the Securities—Interest Payments" in this pricing supplement.

Table of Contents

The level of the Spot Index on any day is calculated by multiplying (1) the level of the Spot Index on the most recent index roll date *times* (2) the *sum* of the *products* of (a) the *quotient* of (i) the spot level of each index constituent currency on the most recent index roll date *divided by* (ii) the spot level of that index constituent currency on the date of calculation *times* (b) the weight of each such index constituent currency in the Spot Index. The level of the Spot Index will be rounded to four decimal points.

The weight of an index constituent currency in the Spot Index is calculated in the following manner. For any calculation date with respect to which the most recent index roll date was an index reconstitution date, the weight of each index constituent currency is 1/15. For all other calculation dates, the weight of an index constituent currency equals (1) 1/15, *times* (2) the *quotient* of (a) (i) the local currency deposit value for that currency on the most recent index roll date *divided by* (ii) the local currency deposit value for that currency on the most recent index reconstitution date, *divided by* (b) (i) the level of the Index on the most recent index roll date *divided by* (ii) the level of the Index on the most recent index reconstitution date.

The index sponsor calculates the level of the Spot Index at approximately 11:00 p.m., London time, on each index business day and publishes it on Bloomberg page BXIIGMSU as soon as practicable thereafter.

Modifications to the Index

The index sponsor does not presently intend to add, remove or replace any of the index constituent currencies or modify the method of calculating the Index as described above. However, in the event of a "potential adjustment event", as described below, the index sponsor may, in its sole discretion, make modifications to the Index. The index sponsor will promptly publish any such modifications on the GEMS index page at http://www.barcap.com/ indices/.

Changes in Index Constituent Currencies or the Denomination of the Index

A potential adjustment event includes any of the following:

- the exchange rate for an index constituent currency splits into dual or multiple exchange rates;
- an event occurs that generally makes it impossible to convert an index constituent currency into U.S. dollars through customary legal channels in an index constituent country;
- an event occurs that generally makes it impossible to deliver U.S. dollars from accounts inside an index constituent country to accounts outside that index constituent country, or to deliver an index constituent currency between accounts inside the index constituent country for such index constituent currency or to a party that is a non-resident of the relevant index constituent country;
- the occurrence of a default, event of default or other similar condition or event with respect to any security or indebtedness of, or guaranteed by, any governmental authority in relation to an index constituent currency;
- any change in, or amendment to, the laws or regulations, including those laws or regulations that relate to taxation, prevailing in the index constituent country in respect of any index constituent currency, or any change in any application or official interpretation of such laws or regulations, or any other governmental action that the index sponsor determines may cause another market disruption event to occur or that leads or may lead to the introduction of a currency peg regime;
- the occurrence of an event that makes it impossible or not reasonably practicable to obtain a firm quote for a currency exchange rate relevant to the Index;
- any nationalization, confiscation, expropriation, requisition or other action by a relevant governmental authority that deprives Barclays Bank PLC or any of its affiliates of all or substantially all of its assets in the relevant index constituent country;

Table of Contents

- the index sponsor determines that there is a material difference in a relevant currency rate as determined by reference to the rate source for the Index and any other market source;
- it becomes impossible to obtain a relevant currency exchange rate, either from the source for that rate or by the index sponsor itself acting in good faith in a commercially reasonable manner;
- the index sponsor determines that an issuer (or dealer) (or any of their affiliates) of Index-linked notes or other Index-linked transactions would be unable, after using commercially reasonable efforts, to acquire, establish, re-establish, substitute, maintain, unwind, or dispose of any hedge position relating to such Index-linked notes or relevant Index-linked transactions, or to realize, recover or remit the proceeds of any such transactions; and
- any event that the index sponsor determines may lead to any of the foregoing events.

If, in the sole discretion of the index sponsor, a potential adjustment event occurs, the index sponsor may replace the index constituent currency to which the potential adjustment event relates with another currency or, as applicable, redenominate the Index in a currency other than the U.S. dollar which, in either case, it determines, in its sole discretion, is comparable for purposes of the Index to the index constituent currency or denominating currency being replaced. Upon any replacement by the index sponsor of an index constituent currency or of the denominating currency following a potential adjustment event, the index sponsor may make any adjustments to the Index as may, in its sole discretion, be required to render the Index comparable to the Index prior to the occurrence of the potential adjustment event.

Market Disruption and Force Majeure

If the index sponsor determines, in its sole discretion, that a market disruption event or a force majeure event (each as defined below) has occurred or is occurring, and that such event affects the Index, any currency included in the Index and/or the ability to hedge the Index or currencies included in the Index, the index sponsor may take any or all of the following actions:

- make such determinations and/or adjustments to the terms of the Index as the index sponsor deems appropriate (including, but not limited to, changing the index constituent currencies or using one or more alternative fixing sources to obtain the value of existing index constituent currencies) for purposes of determining the level of the Index for such day;
- defer publication of information about the Index until the next index business day on which it determines that no market disruption event or force majeure event is occurring; or
- if such day would have been an index roll date but for the occurrence of the market disruption event or force majeure event, defer the index roll date to the next index business day on which no market disruption event or force majeure event is occurring.

Any of the following will constitute a market disruption event:

- on any index business day, the occurrence or existence of either (1) a suspension or limitation imposed on trading any index constituent currency, the U.S. dollar or any tradable instrument, including forwards or options, in respect of an index constituent currency; or (2) any event that, in the opinion of the index sponsor, disrupts or impairs the ability of market participants in general to effect transactions (including any tradable instrument, such as forwards or options) or to obtain market values in relation to any index constituent currency or the U.S. dollar;
- the declaration or continuance of a general moratorium in respect of banking activities in any relevant city;
- on any index business day, the failure of the source from which the index sponsor obtains the value of an index constituent currency to publish such value; and
- on any index business day, the occurrence or existence of a lack of, or a material decline in, the liquidity in the market for trading in any index constituent currency.

Table of Contents

A force majeure event includes any event or circumstance (including, without limitation, a systems failure, natural or man-made disaster, act of God, armed conflict, act of terrorism, riot or labor disruption or any similar intervening circumstance) that the index sponsor determines to be beyond the index sponsor's reasonable control and to materially affect the Index or any index constituent currency.

Taxation

If at any time the index sponsor determines that, as a result of a change in taxation (including, but not limited to, any tax imposed on the index sponsor or its affiliates), it is necessary to change the index constituent currencies, the denomination of the Index or the method of calculating the Index in order to offset the effect of such taxation, the index sponsor may make such change or changes in its sole discretion.

Termination of the Index

The index sponsor may, in its sole discretion, discontinue calculating the Index if any of the following events occurs:

- any index constituent currency or the U.S. dollar ceases or will cease to be traded or publicly quoted and is not and will not be immediately re-listed or re-quoted in a manner acceptable to the index sponsor;
- a potential adjustment event occurs, and the index sponsor determines that an adjustment of the type described in "—Changes in Index Constituent Currencies or the Denomination of the Index" is not reasonably practicable;
- the index sponsor or its successor terminates or alters its business operations, is declared insolvent or is subject to winding-up proceedings; and
- the Index is being terminated, altered or redesigned.

Other Changes

In addition to the foregoing circumstances, the index sponsor reserves the right to make any other changes to the composition or methodology of calculating the Index as the index sponsor may, in its sole discretion, determine to be necessary as a result of market, regulatory, judicial, financial, fiscal or other circumstances.

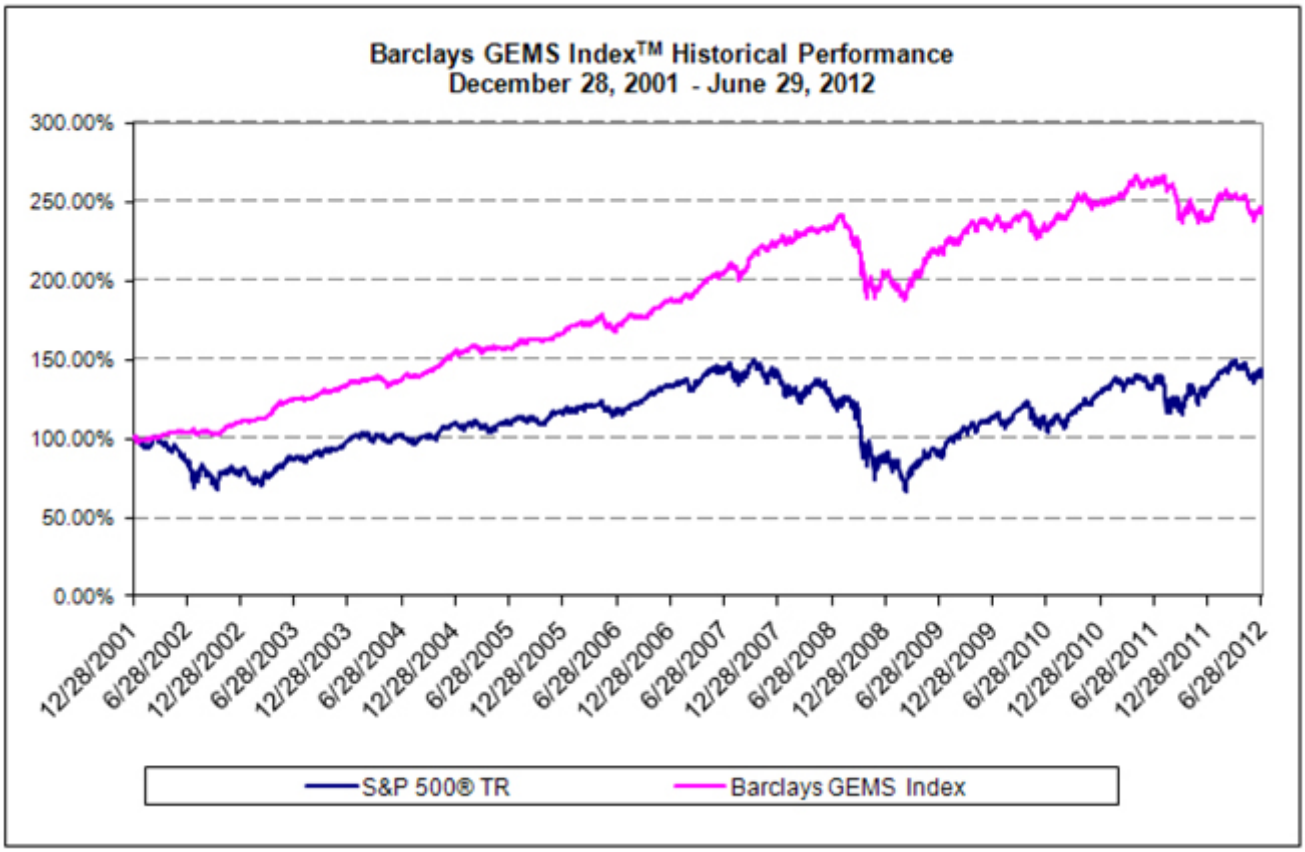
In the event that ambiguities arise in the calculation of the Index, the index sponsor will resolve such ambiguities and, if necessary for resolution, make changes to the composition or methodology of calculating the Index.

Historical Performance of the Index

The following graph illustrates how the Index has performed since the index commencement date. Historical data from the index commencement date to January 2, 2007, the date on which the Index was established, represent hypothetical values as if the Index had been established on the index commencement date and calculated according to the methodology described above since that date. Historical data for dates from and including January 2, 2007 represent the actual values of the Index as calculated on such dates.

The historical performance of the Index should not be taken as an indication of future performance, and no assurance can be given that the value of the Index will increase sufficiently to cause holders of the Securities to receive a payment at maturity or upon redemption equal to or in excess of the principal amount of such Securities.

Table of Contents



PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

Table of Contents

Licensing

Barclays Global Emerging Markets Strategy (GEMS) Index™ and Barclays Global Emerging Markets Strategy (GEMS) Spot Index™ are trademarks of Barclays Bank PLC.

Disclaimer

The index sponsor does not guarantee the accuracy and/or completeness of the Index, any data included therein, or any data from which it is based, and the index sponsor shall have no liability for any errors, omissions, or interruptions therein.

The index sponsor makes no warranty, express or implied, as to the results to be obtained from the use of the Index. The index sponsor makes no express or implied warranties, and expressly disclaims all warranties of merchantability or fitness for a particular purpose or use with respect to the Index or any data included therein. Without limiting any of the foregoing, in no event shall the index sponsor have liability for any special, punitive, indirect or consequential damages, lost profits, loss of opportunity or other financial loss, even if notified of the possibility of such damages.

Neither the index sponsor nor any of its affiliates or subsidiaries or any of their respective directors, officers, employees, representatives, delegates or agents shall have any responsibility to any person (whether as a result of negligence or otherwise) for any determination made or anything done (or omitted to be determined or done) in respect of the Index or publication of the index level (or failure to publish such value) and any use to which any person may put the Index or the index level. In addition, although the index sponsor reserves the right to make adjustments to correct previously incorrectly published information, including but not limited to the index level, the index sponsor is under no obligation to do so and shall have no liability in respect of any errors or omissions.

Nothing in this disclaimer shall exclude or limit liability to the extent such exclusion or limitation is not permitted by law.

VALUATION OF THE SECURITIES

The market value of the Securities will be affected by several factors, many of which are beyond our control. We expect that generally changes in the exchange rates between the index constituent currencies and the U.S. dollar will affect the market value of the Securities more than any other factors. Other factors that may influence the market value of the Securities include, but are not limited to, supply and demand for the Securities, interest rates (including especially the deposit rates for each of the index constituent currencies); the volatility of the exchange rates between the index constituent currencies and the U.S. dollar; economic, financial, political, regulatory, geographical or judicial events that affect the exchange rates or interest rates; and the perceived creditworthiness of Barclays Bank PLC. See “Risk Factors” in this pricing supplement for a discussion of the factors that may influence the market value of the Securities prior to maturity.

Intraday Indicative Value

An intraday “indicative value” meant to approximate the intrinsic economic value of the Securities will be calculated and published by Bloomberg L.P. or a successor via the facilities of the Consolidated Tape Association under the ticker symbol JEM.IV. In connection with your Securities, we use the term “indicative value” to refer to the value at a given time determined based on the following equation:

Indicative Value = Closing Indicative Value on the immediately preceding calendar day (or the Ex Coupon Indicative Value if such day was an Index Roll Date) × Current Index Factor—Current Investor Fee

where:

Closing Indicative Value = The closing indicative value of the Securities as described in this pricing supplement.

Ex Coupon Indicative Value = The ex coupon indicative value of the Securities as described in this pricing supplement.

Index Roll Date = An index roll date as described in this pricing supplement.

Current Index Factor = The most recent published level of the Index as reported by the index sponsor / the closing level of the Index on the immediately preceding index business day.

Table of Contents

Current Investor Fee = The most recent daily calculation of the investor fee with respect to your Securities, determined as described in this pricing supplement (which, during any trading day, will be the investor fee determined on the preceding calendar day).

Bloomberg L.P. is not affiliated with Barclays Bank PLC and does not approve, endorse, review or recommend Barclays Bank PLC or the Securities.

The indicative value will be derived from sources deemed reliable, but Bloomberg L.P. and its suppliers do not guarantee the correctness or completeness of the indicative value or other information furnished in connection with the Securities. Bloomberg L.P. makes no warranty, express or implied, as to results to be obtained by Barclays Bank PLC, Barclays Bank PLC's customers, holders of the Securities, or any other person or entity from the use of the indicative value or any data included therein. Bloomberg L.P. makes no express or implied warranties, and expressly disclaims all warranties of merchantability or fitness for a particular purpose with respect to the indicative value or any data included therein.

Bloomberg L.P., its employees, subcontractors, agents, suppliers and vendors shall have no liability or responsibility, contingent or otherwise, for any injury or damages, whether caused by the negligence of Bloomberg L.P., its employees, subcontractors, agents, suppliers or vendors or otherwise, arising in connection with the indicative value or the Securities, and shall not be liable for any lost profits, losses, punitive, incidental or consequential damages. Bloomberg L.P. shall not be responsible for or have any liability for any injuries or damages caused by errors, inaccuracies, omissions or any other failure in, or delays or interruptions of, the indicative value, from whatever cause. Bloomberg L.P. is not responsible for the selection of or use of the Index or the Securities, the accuracy and adequacy of Index or information used by Barclays Bank PLC and the resultant output thereof.

The indicative value calculation will be provided for reference purposes only. It is not intended as a price or quotation, or as an offer or solicitation for the purchase, sale, redemption or termination of your Securities, nor will it reflect hedging or transaction costs, credit considerations, market liquidity or bid-offer spreads. Published Index levels from the index sponsor may occasionally be subject to delay or postponement. Any such delays or postponements will affect the current Index level and therefore the indicative value of your Securities. The actual trading price of the Securities may be different from their indicative value.

As discussed in "Specific Terms of the Securities—Payment Upon Redemption", you may, subject to certain restrictions, choose to redeem your Securities on any redemption date during the term of the Securities. If you redeem your Securities on a particular redemption date, you will receive a cash payment per Security equal to the closing indicative value on the applicable valuation date. You must redeem at least 50,000 Securities at one time in order to exercise your right to redeem your Securities on any redemption date. The daily redemption feature is intended to induce arbitrageurs to counteract any trading of the Securities at a discount to their indicative value, though there can be no assurance that arbitrageurs will employ the redemption feature in this manner.

SPECIFIC TERMS OF THE SECURITIES

In this section, references to "holders" mean those who own the Securities registered in their own names, on the books that we or the trustee maintain for this purpose, and not those who own beneficial interests in the Securities registered in street name or in the Securities issued in book-entry form through The Depository Trust Company or another depositary. Owners of beneficial interests in the Securities should read the section entitled "Description of Debt Securities—Legal Ownership; Form of Debt Securities" in the accompanying prospectus.

The Securities are part of a series of debt securities entitled "Global Medium-Term Notes, Series A" (the "medium-term notes") that we may issue under the indenture, dated September 16, 2004, between Barclays Bank PLC and The Bank of New York Mellon, as trustee, from time to time. This pricing supplement summarizes specific financial and other terms that apply to the Securities. Terms that apply generally to all medium-term notes are described in "Description of Medium-Term

Table of Contents

Notes" and "Terms of the Notes" in the accompanying prospectus supplement, and terms that apply generally to all index-linked notes are described in "Reference Assets—Indices" in the accompanying prospectus supplement. The terms described here (i.e., in this pricing supplement) supplement those described in the accompanying prospectus, any accompanying prospectus supplement and any related free writing prospectuses and, if the terms described here are inconsistent with those described in those documents, the terms described here are controlling.

Please note that the information about the price to the public and the proceeds to Barclays Bank PLC on the front cover of this pricing supplement relates only to the initial sale of the Securities. If you have purchased the Securities in a market-making transaction after the initial sale, information about the price and date of sale to you will be provided in a separate confirmation of sale.

We describe the terms of the Securities in more detail below.

Denomination

We will offer the Securities in denominations of $50.

Payment at Maturity

If you hold your Securities to maturity, you will receive a cash payment per Security equal to the closing indicative value on the final valuation date.

The "**closing indicative value**" on any calendar day will be calculated in the following manner. The closing indicative value on the inception date will equal $50. On each subsequent calendar day until maturity or early redemption, the closing indicative value will equal (1) the closing indicative value on the immediately preceding calendar day (or the ex coupon indicative value if such day was an index roll date) *times* (2) the daily index factor on such calendar day (or if such day is not an index business day, one) *minus* (3) the investor fee on such calendar day.

The "**ex coupon indicative value**" on any index roll date will equal (1) the closing indicative value on such date *minus* (2) the amount of the interest payment per Security that will be paid on the coupon payment date immediately following such date.

The "**daily index factor**" on any index business day will equal (1) the closing level of the Index on such index business day *divided by* (2) the closing level of the Index on the immediately preceding index business day.

The "**investor fee**" is equal to 0.89% per year *times* the closing indicative value *times* the daily index factor, calculated on a daily basis in the following manner. The investor fee on the inception date will equal zero. On each subsequent calendar day until maturity or early redemption, the investor fee will be equal to (1) 0.89% *times* (2) the closing indicative value on the immediately preceding calendar day (or the ex coupon indicative value if such day was an index roll date) *times* (3) the daily index factor on that day (or, if such day is not an index business day, one) *divided by* (4) 365.

The "**final valuation date**" is Thursday, January 28, 2038, or, if such date is not a trading day, the next succeeding trading day.

A "**trading day**" is a day on which (1) it is a business day in all of the relevant cities and TARGET is open, (2) trading is generally conducted on NYSE Arca and (3) trading is generally conducted in the interbank market, in each case as determined by the calculation agent in its sole discretion.

An "**index business day**" is a day on which (1) it is a business day in London and New York and (2) TARGET is open.

Maturity Date

If the maturity date stated on the cover of this pricing supplement is not a business day, the maturity date will be the next following business day. If the fifth business day before this day does not qualify as a valuation date (as described below), then the maturity date will be the fifth business day following the final valuation date.

In the event that payment at maturity is deferred beyond the stated maturity date, penalty interest will not accrue or be payable with respect to that deferred payment.

Table of Contents

Payment Upon Redemption

Prior to maturity, you may, subject to certain restrictions, redeem your Securities on any redemption date during the term of the Securities, provided that you present at least 50,000 Securities for redemption, or your broker or other financial intermediary (such as a bank or other financial institution not required to register as a broker-dealer to engage in securities transactions) bundles your Securities for redemption with those of other investors to reach this minimum. If you choose to redeem your Securities on a redemption date, you will receive a cash payment per Security equal to the closing indicative value on the applicable valuation date.

"**Valuation date**" means each business day from February 4, 2008 to January 28, 2038, inclusive or, if such date is not a trading day, the next succeeding trading day, not to exceed five business days.

A "**redemption date**" is the third business day following each valuation date (other than the final valuation date). The final redemption date will be the third business day following the valuation date that is immediately prior to the final valuation date.

In the event that payment upon redemption is deferred beyond the original redemption date, penalty interest will not accrue or be payable with respect to that deferred payment.

Redemption Procedures

You may, subject to the minimum redemption amount described above, elect to redeem your Securities on any redemption date. To redeem your Securities, you must instruct your broker or other person with whom you hold your Securities to take the following steps:

- deliver a notice of redemption, which is attached as Annex A, to us via email by no later than 3:00 p.m., New York City time, on the business day prior to the applicable valuation date. If we receive your notice by the time specified in the preceding sentence, we will respond by sending you a form of confirmation of redemption, which is attached as Annex B;
- deliver the signed confirmation of redemption to us via facsimile in the specified form by 3:00 p.m., New York City time, on the same day. We or our affiliate must acknowledge receipt in order for your confirmation to be effective;
- instruct your DTC custodian to book a delivery vs. payment trade with respect to your Securities on the valuation date at a price equal to the applicable daily redemption value, facing Barclays DTC 5101; and
- cause your DTC custodian to deliver the trade as booked for settlement via DTC at or prior to 10:00 a.m., New York City time, on the applicable redemption date (the third business day following the valuation date).

Different brokerage firms may have different deadlines for accepting instructions from their customers. Accordingly, you should consult the brokerage firm through which you own your interest in the Securities in respect of such deadlines. If we do not receive your notice of redemption by 3:00 p.m., New York City time, or your confirmation of redemption by 3:00 p.m., New York City time, on the business day prior to the applicable valuation date, your notice will not be effective and we will not redeem your Securities on the applicable redemption date. Any redemption instructions for which we (or our affiliate) receive a valid confirmation in accordance with the procedures described above will be irrevocable.

Coupon

On each coupon payment date prior to maturity or early redemption, you will receive an interest payment to reflect the implied interest earned, net of fees, on your Securities from and excluding the index roll date for the immediately preceding month to and including the index roll date for the current month. The amount of the interest payment on any coupon payment date will equal (1) the ex coupon indicative value on the index roll date for the immediately preceding month *times* (2) the *difference between* (a) the monthly IV return and (b) the monthly spot return. For the purpose of calculating the first interest payment, the index roll date for the immediately preceding month shall be deemed to be the inception date, and the ex coupon indicative value on such date shall be deemed to be equal to the closing indicative value.

Table of Contents

The "**coupon payment date**" for each month will be the third business day following the coupon ex date for such month. In the event that an interest payment is deferred beyond the stated coupon payment date, penalty interest will not accrue or be payable with respect to that deferred payment.

The "**coupon ex date**" for each month will be the business day immediately following the index roll date for such month.

The "**monthly IV return**" is the *quotient of* (i) the closing indicative value on the index roll date for the current month *divided by* (ii) the ex coupon indicative value on the index roll date for the immediately preceding month.

The "**monthly spot return**" is the *quotient of* (i) the level of the Spot Index on the index roll date for the current month *divided by* (ii) the level of the Spot Index on the index roll date for the immediately preceding month. In no event, however, will the interest payment on any coupon payment date be less than zero.

Default Amount on Acceleration

If an event of default occurs and the maturity of the Securities is accelerated, we will pay the default amount in respect of the principal of the Securities at maturity. We describe the default amount below under "—Default Amount".

For the purpose of determining whether the holders of our medium-term notes, of which the Securities are a part, are entitled to take any action under the indenture, we will treat the stated principal amount of each Security outstanding as the principal amount of that Security. Although the terms of the Securities may differ from those of the other medium-term notes, holders of specified percentages in principal amount of all medium-term notes, together in some cases with other series of our debt securities, will be able to take action affecting all the medium-term notes, including the Securities. This action may involve changing some of the terms that apply to the medium-term notes, accelerating the maturity of the medium-term notes after a default or waiving some of our obligations under the indenture. We discuss these matters in the attached prospectus under "Description of Debt Securities—Modification and Waiver" and "—Senior Events of Default; Subordinated Events of Default and Defaults; Limitations of Remedies".

Default Amount

The default amount for the Securities on any day will be an amount, determined by the calculation agent in its sole discretion, equal to the cost of having a qualified financial institution, of the kind and selected as described below, expressly assume all our payment and other obligations with respect to the Securities as of that day and as if no default or acceleration had occurred, or to undertake other obligations providing substantially equivalent economic value to you with respect to the Securities. That cost will equal:

- the lowest amount that a qualified financial institution would charge to effect this assumption or undertaking, plus
- the reasonable expenses, including reasonable attorneys' fees, incurred by the holders of the Securities in preparing any documentation necessary for this assumption or undertaking.

During the default quotation period for the Securities, which we describe below, the holders of the Securities and/or we may request a qualified financial institution to provide a quotation of the amount it would charge to effect this assumption or undertaking. If either party obtains a quotation, it must notify the other party in writing of the quotation. The amount referred to in the first bullet point above will equal the lowest—or, if there is only one, the only—quotation obtained, and as to which notice is so given, during the default quotation period. With respect to any quotation, however, the party not obtaining the quotation may object, on reasonable and significant grounds, to the assumption or undertaking by the qualified financial institution providing the quotation and notify the other party in writing of those grounds within two business days after the last day of the default quotation period, in which case that quotation will be disregarded in determining the default amount.

Default Quotation Period

The default quotation period is the period beginning on the day the default amount first becomes due and ending on the third business day after that day, unless:

- no quotation of the kind referred to above is obtained, or

Table of Contents

- every quotation of that kind obtained is objected to within five business days after the due date as described above.

If either of these two events occurs, the default quotation period will continue until the third business day after the first business day on which prompt notice of a quotation is given as described above. If that quotation is objected to as described above within five business days after that first business day, however, the default quotation period will continue as described in the prior sentence and this sentence.

In any event, if the default quotation period and the subsequent two business day objection period have not ended before the final valuation date, then the default amount will equal the principal amount of the Securities.

Qualified Financial Institutions

For the purpose of determining the default amount at any time, a qualified financial institution must be a financial institution organized under the laws of any jurisdiction in the United States of America or Europe, which at that time has outstanding debt obligations with a stated maturity of one year or less from the date of issue and rated either:

- A-1 or higher by Standard & Poor's, a division of the McGraw-Hill Companies, Inc., or any successor, or any other comparable rating then used by that rating agency, or
- P-1 or higher by Moody's Investors Service, Inc. or any successor, or any other comparable rating then used by that rating agency.

Further Issuances

We may, without your consent, create and issue additional securities having the same terms and conditions as the Securities. If there is substantial demand for the Securities, we may issue additional Securities frequently. We may consolidate the additional securities to form a single class with the outstanding Securities.

Discontinuance or Modification of the Index

If the index sponsor discontinues publication of the Index and any other person or entity publishes an index that the calculation agent determines is comparable to the Index and the calculation agent approves such index as a successor index, then the calculation agent will determine the value of the Index on the applicable valuation date and the amount payable at maturity or upon redemption and on each coupon payment date by reference to such successor index.

If the calculation agent determines that the publication of the Index is discontinued and there is no successor index, or that the closing value of the Index is not available for any reason, on the date on which the value of the Index is required to be determined, the calculation agent will determine the amount payable by a computation methodology that the calculation agent determines will as closely as reasonably possible replicate the Index.

If the calculation agent determines that the Index, the index constituent currencies or the method of calculating the Index has been changed at any time in any respect—including any addition, deletion or substitution and any unscheduled reweighting or rebalancing of index constituent currencies, and whether the change is made by the index sponsor under its existing policies or following a modification of those policies, is due to the publication of a successor index, is due to events affecting one or more of the index constituent currencies, or is due to any other reason—then the calculation agent will be permitted (but not required) to make such adjustments to the Index or method of calculating the Index as it believes are appropriate to ensure that the value of the Index used to determine the amount payable on the maturity date or upon redemption or on any interest payment date is equitable.

All determinations and adjustments to be made by the calculation agent may be made in the calculation agent's sole discretion. See "Risk Factors" in this pricing supplement for a discussion of certain conflicts of interest which may arise with respect to the calculation agent.

Table of Contents

Manner of Payment and Delivery

Any payment on or delivery of the Securities at maturity will be made to accounts designated by you and approved by us, or at the office of the trustee in New York City, but only when the Securities are surrendered to the trustee at that office. We also may make any payment or delivery in accordance with the applicable procedures of the depositary.

Business Day

When we refer to a business day with respect to the Securities, unless otherwise specified we mean a Monday, Tuesday, Wednesday, Thursday or Friday that is not a day on which banking institutions in London or New York City generally are authorized or obligated by law, regulation or executive order to close.

When we refer to an index business day with respect to the Securities, we mean a day on which (1) it is a business day in London and New York and (2) TARGET is open.

When we refer to a day that is a business day in all of the relevant cities, we mean a Monday, Tuesday, Wednesday, Thursday or Friday that is not a day on which banking institutions in any of the relevant cities generally are authorized or obligated by law, regulation or executive order to close.

Role of Calculation Agent

Currently, we serve as the calculation agent. We may change the calculation agent without notice. The calculation agent will, in its sole discretion, make all determinations regarding the value of the Securities, including at maturity or upon redemption, interest payments, business days, trading days, the closing indicative value, the daily index factor, the default amount, the level of the Index on the inception date, any valuation date and any index roll date, the investor fee, the maturity date, redemption dates, valuation dates, index roll dates, coupon ex dates, coupon payment dates, the amount payable in respect of your Securities at maturity or upon redemption and any other calculations or determinations to be made by the calculation agent as specified herein. Absent manifest error, all determinations of the calculation agent will be final and binding on you and us, without any liability on the part of the calculation agent. You will not be entitled to any compensation from us for any loss suffered as a result of any of the above determinations by the calculation agent.

CLEARANCE AND SETTLEMENT

Depository Trust Company ("DTC") participants that hold the Securities through DTC on behalf of investors will follow the settlement practices applicable to equity securities in DTC's settlement system with respect to the primary distribution of the Securities and secondary market trading between DTC participants.

USE OF PROCEEDS AND HEDGING

We will use the net proceeds we receive from the sale of the Securities for the purposes we describe in the attached prospectus supplement under "Use of Proceeds and Hedging". We or our affiliates may also use those proceeds in transactions intended to hedge our obligations under the Securities as described below.

In anticipation of the sale of the Securities, we or our affiliates expect to enter into hedging transactions involving purchases of index constituent currencies or U.S. dollars or instruments linked to the Index, index constituent currencies, the U.S. dollar or the exchange rate between index constituent currencies and the U.S. dollar prior to or on the inception date. In addition, from time to time after we issue the Securities, we or our affiliates may enter into additional hedging transactions or unwind those hedging transactions we have entered into. In this regard, we or our affiliates may:

- acquire or dispose of long or short positions in listed or over-the-counter options, futures or other instruments linked to the Index, index constituent currencies, the U.S. dollar or the exchange rate between index constituent currencies and the U.S. dollar;
- acquire or dispose of long or short positions in listed or over-the-counter options, futures or other instruments linked to other exchange rates or currencies; or
- any combination of the above two.

We or our affiliates may acquire a long or short position in securities similar to the Securities from time to time and may, in our or their sole discretion, hold or resell those securities.

PS-30

Table of Contents

We or our affiliates may close out our or their hedge positions on or before the final valuation date. That step may involve sales or purchases of listed or over-the-counter options or futures on the U.S. dollar or the euro or listed or over-the-counter options, futures or other instruments linked to the Index, index constituent currencies, the U.S. dollar or the exchange rate between index constituent currencies and the U.S. dollar, as well as instruments designed to track the performance of other exchange rates or currencies.

The hedging activity discussed above may have a negative effect on the market value of the Securities from time to time and the amount payable at maturity or upon redemption. See “Risk Factors” in this pricing supplement for a discussion of possible adverse effects related to our hedging activities.

MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS

The following section supplements the discussion of U.S. federal income taxation in the accompanying prospectus supplement. The following section is the opinion of Sullivan & Cromwell LLP, counsel to Barclays Bank PLC. Except for the discussion under the heading “Non-U.S. Holders” below, it applies to you only if you are a U.S. holder (as defined below), you acquire your Security in the offering at the offering price or at a later time for its closing indicative value (as defined under “Specific Terms of the Securities—Payment at Maturity) at the time of acquisition, and you hold your Security as a capital asset for tax purposes. **This section does not apply to you if you are a secondary purchaser of the Securities and you acquire your Securities for a price that is not equal to their closing indicative value at the time of acquisition.** This section also does not apply to you if you are a member of a class of holders subject to special rules, such as:

- a dealer in securities or currencies;
- a trader in securities that elects to use a mark-to-market method of accounting for your securities holdings;
- a bank;
- a life insurance company;
- a tax-exempt organization;
- a regulated investment company;
- a partnership or other pass-through entity;
- a person that owns a Security as a hedge or that is hedged against interest rate or currency risks;
- a person that owns a Security as part of a straddle or conversion transaction for tax purposes; or
- a U.S. holder (as defined below) whose functional currency for tax purposes is not the U.S. dollar.

This section is based on the U.S. Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations under the Internal Revenue Code, published rulings and court decisions, all as currently in effect. These laws are subject to change, possibly on a retroactive basis.

You should consult your tax advisor concerning the U.S. federal income tax and other tax consequences of your investment in the Securities in your particular circumstances, including the application of state, local or other tax laws and the possible effects of changes in federal or other tax laws.

Except for the discussion under the heading “Non-U.S. Holders” below, this section describes the tax consequences to a U.S. holder. You are a U.S. holder if you are a beneficial owner of a Security and you are for U.S. federal income tax purposes:

- a citizen or resident of the United States;
- a domestic corporation;
- an estate whose income is subject to U.S. federal income tax regardless of its source; or
- a trust if a U.S. court can exercise primary supervision over the trust’s administration and one or more U.S. persons are authorized to control all substantial decisions of the trust.

In the opinion of our counsel Sullivan & Cromwell LLP, the treatment of the Securities

Table of Contents

described below is a reasonable interpretation of U.S. federal income tax law. This opinion assumes that the description of the terms of the Securities in this pricing supplement is materially correct. Pursuant to the terms of the Securities, Barclays Bank PLC and you agree, in the absence of a change in law or an administrative or judicial ruling to the contrary, to characterize your Securities in the manner described below for all U.S. federal income tax purposes.

Treatment of the Securities.

There is no authority that directly addresses the proper U.S. federal income tax treatment of your Securities and therefore the U.S. federal income tax consequences of your investment in the Securities are highly uncertain. In the opinion of our counsel Sullivan & Cromwell LLP, although your Securities are denominated in U.S. dollars, it would be reasonable to treat the Securities as a contingent foreign currency denominated debt instrument for U.S. federal income tax purposes. We believe that the treatment of the Securities as a contingent foreign currency denominated debt instrument is generally consistent with the guidance contained in Revenue Ruling 2008-1, which ruled that an instrument that obligated the issuer to deliver a fixed amount of a foreign currency will be treated as a foreign currency denominated debt instrument. The Securities offer to deliver the economic equivalent of 15 different currencies at redemption or maturity and, because the Index rebalances annually, an investor is not guaranteed a fixed amount in any particular foreign currency at such time. Nevertheless, we believe that it would be reasonable to conclude that the principles set forth in Revenue Ruling 2008-1 should apply under these circumstances.

Under the rules applicable to contingent foreign currency denominated debt instruments that are denominated in more than one foreign currency, you are required to accrue interest based on the comparable yield of the “predominant currency” of such instrument. The “predominant currency” is generally the foreign currency with the greatest value determined by calculating the present value of the payments projected to be made in each foreign currency. For this purpose, because you will be treating the Securities as foreign currency denominated debt, payments of interest and principal that are actually made in U.S. dollars will be treated as if they were made in each of the index constituent currencies. In light of the particular terms of the Securities and our inability to determine in any economically meaningful way whether any one of the index constituent currencies is the “predominant currency” under this test, we believe that it would be reasonable to take the approach that there is no “predominant currency” for the Securities.

There are no rules that address the proper treatment of a contingent foreign currency denominated debt instrument that does not have a “predominant currency”. Accordingly, considering the purpose of the rules generally applicable to contingent foreign currency denominated debt and the terms of the Securities, we believe that it would be reasonable for you to generally include the interest paid on the Securities in your gross income at the time when the stated interest accrues.

For purposes of Treasury Regulation § 1.1275-4(b)(4)(iv) and for the reasons described above, the issuer is using the actual amounts of the interest payable, as determined from time to time, as the comparable yield and projected payment schedule for the Securities.

Method of Interest Accrual of Interest for Stub Years.

It is not entirely clear how to determine the rate at which interest should be accrued over each interest accrual period**.** Nonetheless, the amount of income that is recognized by a holder of the Securities should generally not be affected by the rate at which such holder accrues interest (because any difference between the amount accrued and the amount received would be adjusted when the interest is received) except in the case of an interest accrual period that includes the close of a holder’s taxable year. While there are no rules that address this question, we think that it would be reasonable for a holder (i) with respect to any accrual period that falls entirely within the holder’s taxable year, to accrue the U.S. dollar amount of interest actually received for the period, and (ii) with respect to any accrual period that spans the close of the holder’s taxable year, to accrue, (a) for the part of the accrual period that falls within the taxable year, a percentage of the actual U.S. dollar amount of interest that is received in the following taxable year equal to

Table of Contents

the ratio of the number of days in the accrual period that fall within the taxable year that has closed to the total number of days in the accrual period and (b) for the part of the accrual period that falls in the following taxable year, to accrue the difference between the amount of interest that is actually received less the amount of interest that was accrued in the prior taxable year.

Sale, Redemption or Maturity.

You will generally recognize gain or loss upon the sale, redemption or maturity of your Securities in an amount equal to the difference between the amount you receive at such time and your tax basis in the Securities. In general, your tax basis in your Securities will be equal to the U.S. dollar cost of your Securities increased by any accrued but unpaid interest (and decreased by the same amount once the accrued interest is paid).

Because we will treat the Securities as having no "predominant currency", under the special rules applicable to contingent foreign currency denominated debt instruments, we believe it is reasonable to treat all contingent payments with respect to your Securities as non-currency related contingencies that are subject to the rules generally applicable to non-currency contingent debt instruments. Under such rules, any gain you may recognize on the sale, redemption or maturity of the Securities would be ordinary interest income and any loss you may recognize upon the sale, redemption or maturity of the Securities would generally be ordinary loss to the extent of the interest you included as income in the current or previous taxable years in respect of the Securities and thereafter would be capital loss. The deductibility of capital losses is subject to limitations.

Secondary Purchasers.

If you are a secondary purchaser of the Securities, the U.S. federal income tax treatment of your Securities is uncertain. In the opinion of our counsel Sullivan & Cromwell LLP, if you acquire your Securities for a price equal to their closing indicative value at the time of acquisition, it would be reasonable to treat your Securities in the same manner described above with respect to an initial purchaser of the Securities, and, pursuant to the terms of the Securities, Barclays Bank PLC and you agree, in the absence of a change in law or an administrative or judicial ruling to the contrary, to characterize your Securities in such manner. More specifically, under the rules set forth in applicable Treasury regulations, a secondary purchaser of a contingent debt instrument that acquires the instrument for an amount other than its adjusted issue price is required to make positive or negative adjustments to its interest accruals in respect of the debt instrument to account for differences between the instrument's adjusted issue price and its purchase price. As discussed above, we believe that it would be reasonable to take the position that the Securities do not have a predominant currency. If the Securities are properly treated as lacking a predominant currency, we believe that it would be reasonable to treat the Securities as having an adjusted issue price equal to their principal amount (in foreign currency terms) plus accrued but unpaid interest, which we understand from the Issuer should generally be equal to their closing indicative value. Accordingly, we think that it would be reasonable to treat a purchaser of Securities for a price equal to their closing indicative value as purchasing the Securities for an amount equal to their adjusted issue price and that it would accordingly be reasonable to accrue interest on such Securities in the same manner as an initial purchaser, without any positive or negative adjustments. You should be aware, however, that the Internal Revenue Service may not agree with such treatment and may require a secondary purchaser to accrue interest in a different manner than an initial purchaser or to make positive or negative adjustments in respect of its interest accruals. In addition, please note that the discussion above only applies to secondary purchasers who acquire their Securities for a price equal to their closing indicative value at the time of acquisition. If you acquire your Securities for a price other than their closing indicative value at the time of acquisition, please consult your tax advisor regarding the tax treatment of your Securities.

Treasury Regulations Requiring Disclosure of Reportable Transactions.

Treasury regulations require United States taxpayers to report certain transactions that give rise to a loss in excess of certain thresholds (a "Reportable Transaction"). Under these

Table of Contents

regulations, a U.S. holder that recognizes a loss with respect to the Securities that is characterized as exchange loss would be required to report the loss on Internal Revenue Service Form 8886 (Reportable Transaction Statement) if such loss exceeded the thresholds set forth in the regulations. For individuals and trusts, this loss threshold is $50,000 in any single taxable year. For other types of taxpayers and other types of losses, the thresholds are higher. While we believe it is reasonable to take the position that loss recognized in respect of the Securities would not be exchange loss, it is possible that some or all of any loss realized on the Securities may be characterized as exchange loss. You should consult your tax advisor regarding any tax filing and reporting obligations—including any protective filings—that ought to be made in connection with any loss realized in connection with acquiring, owning and disposing of Securities.

Alternative Treatments.

As mentioned above, there is no judicial or administrative authority discussing how your Security should be treated for United States federal income tax purposes. Therefore, other treatments would also be possible and the Internal Revenue Service might assert that treatment other than that described above is more appropriate. For example, it would be possible to treat your Security, and the Internal Revenue Service might assert that your Security should be treated as 15 separate debt instruments that are sold and repurchased on each index reconstitution date. Under this characterization, you would recognize exchange gain or loss based on the movement of each of the relevant exchange rates on each index reconstitution date.

In addition, while the Securities might be treated as contingent foreign currency denominated debt instruments as described above, they might also be treated as having a “predominant currency”. If your Securities were treated as having a “predominant currency”, you would likely be required to accrue interest for each accrual period in an amount determined by constructing a projected payment schedule for the Securities in such “predominant currency” and applying the rules similar to those for accruing original issue discount on a hypothetical noncontingent debt instrument with that projected payment schedule. This method would be applied by first determining the yield at which we would issue a noncontingent fixed rate debt instrument denominated in the “predominant currency” with terms and conditions similar to the Securities and then determining a payment schedule as of the issue date that would produce the comparable yield. In addition, even if these rules applied, under certain circumstances it may be possible that the comparable yield and the projected payment schedule for the Securities could be determined in a manner that would require you to accrue an amount of interest in certain taxable years that exceeds the actual amount of interest that you receive in such years. Moreover, even if the Securities are treated as contingent foreign currency denominated debt instruments that do not have a “predominant currency”, it is possible that the gain or loss that you recognize upon the sale, redemption or maturity of your Securities would be exchange gain or loss, which will generally be treated as-U.S. source ordinary income or loss. In such case, you may also be subject to certain reporting requirements as described above under “—Treasury Regulations Requiring Disclosure of Reportable Transactions”. It is also possible that your Securities could be treated in the manner described under “—Treatment of the Securities” above, except that you would be required to accrue interest using a method that differs from the accrual method described above.

It is also possible that the Securities might not be treated as debt for U.S. federal income tax purposes. Other alternative treatments are also possible. You should consult your tax advisor as to the tax consequences of any possible alternative characterizations of your Securities for U.S. federal income tax purposes.

In addition, the Internal Revenue Service could potentially assert that you should be required to treat amounts attributable to the investor fee as amounts of expense. The deduction of any such deemed expenses would generally be subject to the 2% floor on miscellaneous itemized deductions. Such amounts would correspondingly increase the amount of gain or decrease the amount of loss that you recognize with respect to your Securities. Under this alternative treatment, you could also be required to recognize amounts of gain or loss as if you had sold a portion of your Securities to pay the accrued fees.

Table of Contents

In addition, it is possible that you could be required to recognize gain or loss at any time when the Index is modified, adjusted, discontinued or replaced with a successor index.

"Specified Foreign Financial Asset" Reporting

Under legislation enacted in 2010, owners of "specified foreign financial assets" with an aggregate value in excess of $50,000 (and in some circumstances, a higher threshold) may be required to file an information report with respect to such assets with their tax returns. "Specified foreign financial assets" generally include any financial accounts maintained by foreign financial institutions (which would include debt of a foreign financial institution that is not regularly traded on an established securities market), as well as any of the following, but only if they are not held in accounts maintained by financial institutions: (i) stocks and securities issued by non-U.S. persons, (ii) financial instruments and contracts held for investment that have non-U.S. issuers or counterparties and (iii) interests in foreign entities. Holders are urged to consult their tax advisors regarding the application of this legislation to their ownership of the Securities.

Non-U.S. Holders.

*B*arclays Bank PLC currently does not withhold on payments treated as interest to non-U.S. holders in respect of instruments such as the Securities. However, if Barclays Bank PLC determines that there is a material risk that it will be required to withhold on any such payments, Barclays Bank PLC may withhold on any payments treated as interest at a 30% rate, unless you have provided to Barclays Bank PLC an appropriate and valid Internal Revenue Service Form W-8. In addition, non-U.S. holders will be subject to the general rules regarding information reporting and backup withholding as described under the heading "Certain U.S. Federal Income Tax Considerations —Information Reporting and Backup Withholding" in the accompanying prospectus supplement.

Information Reporting and Backup Withholding

Please see the discussion under "Certain U.S. Federal Income Tax Considerations—Information Reporting and Backup Withholding" in the accompanying prospectus supplement for a description of the applicability of the information reporting and backup withholding rules to payments made on your Securities.

SUPPLEMENTAL PLAN OF DISTRIBUTION

We sold a portion of the Securities on the inception date at 100% of the stated principal amount. The remainder of the Securities will be offered and sold from time to time through Barclays Capital Inc., our affiliate, as agent. Sales of the remaining Securities by us will be made at market prices prevailing at the time of sale, at prices related to market prices or at negotiated prices. Barclays Capital Inc. will not receive an agent's commission in connection with sales of the Securities.

In connection with this offering, we will sell the Securities to dealers as principal, and such dealers may then resell Securities to the public at varying prices that the dealers will determine at the time of resale. In addition, such dealers may make a market in the Securities, although none of them are obligated to do so and any of them may stop doing so at any time without notice. This prospectus (including this pricing supplement and the accompanying prospectus and prospectus supplement) may be used by such dealers in connection with market-making transactions. In these transactions, dealers may resell a Security covered by this prospectus that they acquire from other holders after the original offering and sale of the Securities, or they may sell a Security covered by this prospectus in short sale transactions.

Broker-dealers and other persons are cautioned that some of their activities may result in their being deemed participants in the distribution of the Securities in a manner that would render them statutory underwriters and subject them to the prospectus delivery and liability provisions of the Securities Act. Among other activities, broker-dealers and other persons may make short sales of the Securities and may cover such short positions by borrowing Securities from us or our affiliates or by purchasing Securities from us or our affiliates subject to our obligation to repurchase such Securities at a later date. As a result of these activities, these market participants may be deemed statutory underwriters. A determination of whether a particular market participant is an underwriter

Table of Contents

must take into account all the facts and circumstances pertaining to the activities of the participant in the particular case, and the example mentioned above should not be considered a complete description of all the activities that would lead to designation as an underwriter and subject a market participant to the prospectus-delivery and liability provisions of the Securities Act. This prospectus will be deemed to cover any short sales of Securities by market participants who cover their short positions with Securities borrowed or acquired from us or our affiliates in the manner described above.

Barclays Bank PLC and Barclays Capital Inc. have retained the services of BlackRock Investments, LLC, a member of the Financial Industry Regulatory Authority, Inc., to promote the Securities and provide certain services relating to the Securities. BlackRock Investments, LLC may receive a portion of the investor fee in connection with these services. Underwriting compensation will not exceed a total of 8% of proceeds.

Table of Contents

ANNEX A

NOTICE OF REDEMPTION

To: ipathredemptions@barclays.com

Subject: iPath® Notice of Redemption, CUSIP No. 06739H453

[BODY OF EMAIL]

Name of holder: [ ]

Number of Securities to be redeemed: [ ]

Applicable Valuation Date: [ ], 20[ ]

Contact Name: [ ]

Telephone #: [ ]

Acknowledgement: I acknowledge that the Securities specified above will not be redeemed unless all of the requirements specified in the pricing supplement relating to the Securities are satisfied.

Table of Contents

ANNEX B

CONFIRMATION OF REDEMPTION

Dated:

Barclays Bank PLC

Barclays Bank PLC, as Calculation Agent

Fax: 212-412-1232

Dear Sir/Madam:

The undersigned holder of Barclays Bank PLC's $250,000,000 Global Medium-Term Notes, Series A, iPath® GEMS Index™ ETNs due February 4, 2038 CUSIP No. 06739H453, redeemable for a cash amount based on the performance of the Barclays Global Emerging Markets Strategy (GEMS) Index™ (the "Securities") hereby irrevocably elects to exercise, on the redemption date of , with respect to the number of Securities indicated below, as of the date hereof, the redemption right as described in the prospectus relating to the Securities (the "Prospectus"). Terms not defined herein have the meanings given to such terms in the Prospectus.

The undersigned certifies to you that it will (i) instruct its DTC custodian with respect to the Securities (specified below) to book a delivery vs. payment trade on the valuation date with respect to the number of Securities specified below at a price per Security equal to the applicable daily redemption value, facing Barclays DTC 5101 and (ii) cause the DTC custodian to deliver the trade as booked for settlement via DTC at or prior to 10:00 a.m., New York City time, on the redemption date.

Very truly yours,
[NAME OF HOLDER]

_____
Name:
Title:
Telephone:
Fax:
E-mail:

Number of Securities surrendered for redemption: _____

DTC # (and any relevant sub-account): _____
Contact Name:
Telephone:

(You must redeem at least 50,000 Securities at one time in order to exercise your right to redeem your Securities on any redemption date.)

Table of Contents

BARCLAYS BANK PLC

$250,000,000
iPath® GEMS Index™ ETN

GLOBAL MEDIUM-TERM NOTES, SERIES A

Pricing Supplement

August 23, 2012

(to Prospectus dated August 31, 2010 and
Prospectus Supplement dated May 27, 2011)

Patent Pending

iP-P-143-08012

424B2 1 dp65564_424b2-ps896.htm FORM 424B2

PROSPECTUS Dated February 16, 2016
PROSPECTUS SUPPLEMENT Dated November 19, 2014

Pricing Supplement No. 896 to
Registration Statement No. 333-200365
Dated May 2, 2016
Rule 424(b)(2)

Morgan Stanley

STRUCTURED INVESTMENTS
Opportunities in Currencies

$17,217,000

Leveraged Currency-Linked Notes due June 9, 2017

Principal at Risk Securities

The notes will not bear interest. The amount that you will be paid on your notes on the stated maturity date (June 9, 2017) is based on the performance of the U.S. dollar relative to the euro, as measured by the specific currency return formula described below, from the trade date (May 2, 2016) to and including the determination date (June 6, 2017, subject to adjustment). The exchange rate is expressed as the number of U.S. dollars needed to buy one euro. An increase in the exchange rate means that the U.S. dollar has depreciated relative to the euro such that it takes more dollars to purchase one euro. Conversely, a decrease in the exchange rate means that the U.S. dollar has appreciated relative to the euro such that it takes fewer dollars to purchase one euro. By purchasing the notes, you are taking the view that the currency return on the determination date will be positive, which means that the final exchange rate (as described below) will be lower than the initial exchange rate (i.e. it will take fewer dollars to purchase one euro at the final exchange rate than at the initial exchange rate). If the currency return is positive or zero, you will receive $1,000 *plus* $1,000 *times* the upside participation rate of 137% *times* the currency return, resulting in a maximum payment at maturity of $2,370. **However, if the currency return is negative (the number of dollars required to purchase one euro on the determination date is greater than the number of dollars required to purchase one euro on the trade date), the return on your notes will be negative. You could lose your entire investment in the notes.** The notes are notes issued as part of Morgan Stanley's Series F Global Medium-Term Notes program.

All payments are subject to the credit risk of Morgan Stanley. If Morgan Stanley defaults on its obligations, you could lose some or all of your investment. These notes are not secured obligations and you will not have any security interest in, or otherwise have any access to, any underlying reference asset or assets.

To determine your payment at maturity, we will calculate the currency return, which is the *quotient* of (i) the initial exchange rate *minus* the final exchange rate *divided* by (ii) the initial exchange rate, expressed as a percentage. On the stated maturity date, for each $1,000 face amount of your notes, you will receive an amount in cash equal to:

- if the currency return is *positive* or *zero*, the *sum* of (i) $1,000 *plus* (ii) the *product* of (a) $1,000 *times* (b) the upside participation rate of 137% *times* (c) the currency return; or
- if the currency return is *negative,* the *sum* of (i) $1,000 *plus* (ii) the *product* of the currency return *times* $1,000, subject to a minimum payment at maturity of $0.

  If the currency return is negative (the number of dollars required to purchase one euro on the determination date is greater than the number required to purchase one euro on the trade date), you will lose some or all of your investment.

You should read the additional disclosure herein so that you may better understand the terms and risks of your investment.

The estimated value on the trade date is $981.20 per note. See "Estimated Value" on page 2.

	Price to public	*Agent's commissions(1)*	*Proceeds to issuer(2)*
Per note	*$1,000*	*$9.30*	*$990.70*
Total	*$17,217,000*	*$160,118.10*	*$17,056,881.90*

(1) Morgan Stanley & Co. LLC ("MS & Co.") will sell all of the notes that it purchases from us to an unaffiliated dealer. The price to public is 99.07% for certain investors; see "Summary Information — Supplemental information regarding plan of distribution; conflicts of interest" on page 7. Investors that purchase and hold the notes in fee-based accounts may be charged fees based on the amount of assets held in those accounts, including the notes.

(2) See "Summary Information—Use of proceeds and hedging" beginning on page 5.

The notes involve risks not associated with an investment in ordinary debt securities. See "Risk Factors" beginning on page 12.

The Securities and Exchange Commission and state securities regulators have not approved or disapproved these notes, or determined if this document or the accompanying prospectus supplement and prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The notes are not deposits or savings accounts and are not insured by the Federal Deposit Insurance Corporation or any other governmental agency or instrumentality, nor are they obligations of, or guaranteed by, a bank.

You should read this document together with the related prospectus supplement and prospectus, each of which can be accessed via the hyperlinks below. Please also see "Key Terms" on page 3.

MORGAN STANLEY

About Your Prospectus

The notes are notes issued as part of Morgan Stanley's Series F Global Medium-Term Notes program. This prospectus includes this pricing supplement and the accompanying documents listed below. This pricing supplement constitutes a supplement to the documents listed below and should be read in conjunction with such documents:

- Prospectus dated February 16, 2016
- Prospectus Supplement dated November 19, 2014

The information in this pricing supplement supersedes any conflicting information in the documents listed above. In addition, some of the terms or features described in the listed documents may not apply to your notes.

ESTIMATED VALUE

The Original Issue Price of each note is $1,000. This price includes costs associated with issuing, selling, structuring and hedging the notes, which are borne by you, and, consequently, the estimated value of the notes on the Trade Date is less than $1,000. We estimate that the value of each note on the Trade Date is $981.20.

What goes into the estimated value on the Trade Date?

In valuing the notes on the Trade Date, we take into account that the notes comprise both a debt component and a performance-based component linked to the Exchange Rate (as defined herein). The estimated value of the notes is determined using our own pricing and valuation models, market inputs and assumptions relating to the Exchange Rate, instruments based on the Exchange Rate, volatility and other factors including current and expected interest rates, as well as an interest rate related to our secondary market credit spread, which is the implied interest rate at which our conventional fixed rate debt trades in the secondary market.

What determines the economic terms of the notes?

In determining the economic terms of the notes, including the Upside Participation Rate, we use an internal funding rate, which is likely to be lower than our secondary market credit spreads and therefore advantageous to us. If the issuing, selling, structuring and hedging costs borne by you were lower or if the internal funding rate were higher, one or more of the economic terms of the notes would be more favorable to you.

What is the relationship between the estimated value on the Trade Date and the secondary market price of the notes?

The price at which MS & Co. purchases the notes in the secondary market, absent changes in market conditions, including those related to the Exchange Rate, may vary from, and be lower than, the estimated value on the Trade Date, because the secondary market price takes into account our secondary market credit spread as well as the bid-offer spread that MS & Co. would charge in a secondary market transaction of this type and other factors. However, because the costs associated with issuing, selling, structuring and hedging the notes are not fully deducted upon issuance, for a period of up to 6 months following the issue date, to the extent that MS & Co. may buy or sell the notes in the secondary market, absent changes in market conditions, including those related to the Exchange Rate, and to our secondary market credit spreads, it would do so based on values higher than the estimated value. We expect that those higher values will also be reflected in your brokerage account statements.

MS & Co. may, but is not obligated to, make a market in the notes, and, if it once chooses to make a market, may cease doing so at any time.

SUMMARY INFORMATION

The Leveraged Currency-Linked Notes, which we refer to as the notes, are unsecured obligations of Morgan Stanley, will pay no interest, do not guarantee any return of principal at maturity and have the terms described in the accompanying prospectus supplement and prospectus, as supplemented or modified by this document. The notes are notes issued as part of Morgan Stanley's Series F Global Medium-Term Notes program.

Capitalized terms used but not defined herein have the meanings assigned to them in the accompanying prospectus supplement and prospectus. All references to "Cash Settlement Amount," "Determination Date," "Face Amount," "Original Issue Price," "Stated Maturity Date," "Trade Date," "Currency Return" and "Upside Participation Rate" herein shall be deemed to refer to "payment at maturity," "valuation date," "stated principal amount," "issue price," "maturity date," "pricing date," "currency performance" and "leverage factor," respectively, as used in the accompanying prospectus supplement.

If the terms described herein are inconsistent with those described in the accompanying prospectus supplement or prospectus, the terms described herein shall control.

Key Terms

Issuer: Morgan Stanley

Exchange Rate: the USD/EUR exchange rate, expressed as the number of U.S. dollars needed to buy one euro. An increase in the Exchange Rate means that the U.S. dollar has depreciated relative to the euro, such that it takes more dollars to purchase one euro. Conversely, a decrease in the Exchange Rate means that the U.S. dollar has appreciated relative to the euro, such that it takes fewer dollars to purchase one euro. By purchasing the notes, you are taking the view that the Currency Return on the Determination Date will be positive, which means that the Final Exchange Rate (as described below) will be lower than the Initial Exchange Rate (i.e. it will take fewer dollars to purchase one euro at the Final Exchange Rate than at the Initial Exchange Rate).

Specified currency: U.S. dollars ("$")

Face Amount: Each note will have a Face Amount of $1,000; $17,217,000 in the aggregate for all the notes; the aggregate Face Amount of notes may be increased if the Issuer, at its sole option, decides to sell an additional amount of the notes on a date subsequent to the date hereof.

Denominations: $1,000 and integral multiples thereof

Purchase at amount other than Face Amount: The amount we will pay you on the Stated Maturity Date for your notes will not be adjusted based on the issue price you pay for your notes, so if you acquire notes at a premium (or discount) to the Face Amount and hold them to the Stated Maturity Date, it could affect your investment in a number of ways. The return on your investment in such notes will be lower (or higher) than it would have been had you purchased the notes at the Face Amount. See "Risk Factors—If You Purchase Your Notes At A Premium To The Face Amount, The Return On Your Investment Will Be Lower Than The Return On Notes Purchased At The Face Amount, And The Impact Of Certain Key Terms Of The Notes Will Be Negatively Affected" beginning on page 13 of this document.

Cash Settlement Amount: For each $1,000 Face Amount of notes, we will pay you on the Stated Maturity Date an amount in cash equal to:

- if the Currency Return is *positive* or *zero*, the *sum* of (i) $1,000 *plus* (ii) the *product* of (a) $1,000 *times* (b) the Upside Participation Rate *times* (c) the Currency Return; or

- if the Currency Return is *negative,* the *sum* of (i) $1,000 *plus* (ii) the *product* of the Currency Return *times* $1,000, subject to a minimum payment at maturity of $0.

  You will lose some or all of your investment at maturity if the Currency Return is negative (i.e., the number of dollars required to purchase one euro on the Determination Date is greater than the number of dollars required to purchase one euro on the Trade Date).

Initial Exchange Rate: 1.15135, which is the Exchange Rate on the Trade Date

Final Exchange Rate: With respect to the Determination Date, the Exchange Rate on such date, as determined by the Calculation Agent; *provided* that if such date is not a Currency Business Day, the Final Exchange Rate will be the Exchange Rate on the immediately preceding Currency Business Day.

Exchange Rate: On any Currency Business Day, the rate for conversion of U.S. dollars into euros (expressed as the number of U.S. dollars per unit of euro) as determined by reference to the rate displayed on the applicable Reference Source on such Currency Business Day, as determined by the Calculation Agent; *provided* that if (i) no such rate is displayed on the applicable Reference Source for such day or (ii) the Calculation Agent determines in good faith that the rate so displayed on the applicable Reference Source is manifestly incorrect, the Exchange Rate will equal the arithmetic mean, as determined by the Calculation Agent, of the firm quotes of Exchange Rates for conversion of U.S. dollars into euros determined by at least five independent leading dealers, selected by the Calculation Agent (the "reference dealers"), in the underlying market for euro, taking into consideration the latest available quote for such Exchange Rate and any other information deemed relevant by such reference dealers; *provided further* that if (i) the difference between the highest and lowest Exchange Rates for conversion of U.S. dollars into euros determined by the reference dealers on such date pursuant to the previous clause of this sentence is greater than 1% or (ii) the Calculation Agent is unable to obtain five such quotes from the reference dealers on such date for any reason, the Exchange Rate shall be determined by the Calculation Agent in good faith on such day taking into account any information deemed relevant by the Calculation Agent;

Quotations of MS & Co. or the Calculation Agent or any of their affiliates may be included in the calculation of the mean described above, but only to the extent that any such bid is the highest of the quotes obtained.

If the euro is lawfully eliminated, converted, redenominated or exchanged by the European Union after the Trade Date and prior to the Determination Date, the Calculation Agent, in its sole discretion, will determine the Final Exchange Rate, or make such adjustment to the Initial Exchange Rate, on the Determination Date, in accordance with legal requirements and market practice.

Reference Source: The Exchange Rate will be determined by reference to the rate for settlement in two business days published by WM Company that appears on Reuters Page "WMRSPOT05" under the caption "MID" at approximately 4:00 p.m., London time (or any successor service or page).

Currency Return: The *quotient* of (i) the Initial Exchange Rate *minus* the Final Exchange Rate *divided* by (ii) the Initial Exchange Rate, expressed as a percentage.

Upside Participation Rate: 137%

Trade Date: May 2, 2016

Original Issue Date (Settlement Date): May 9, 2016 (5 Business Days after the Trade Date)

Determination Date: June 6, 2017

Stated Maturity Date: June 9, 2017 (3 Business Days after the Determination Date)

No interest: The notes will not pay interest.

No listing: The notes will not be listed on any securities exchange.

No redemption: The notes will not be subject to any redemption right.

Business Day: As described under "Description of PLUS—Some Definitions—business day" on page S-34 of the accompanying prospectus supplement

Currency Business Day: As described under "Description of PLUS—Some Definitions—currency business day" on page S-34 of the accompanying prospectus supplement.

Use of proceeds and hedging: The proceeds we receive from the sale of the notes will be used for general corporate purposes. We will receive, in aggregate, $1,000 per note issued. The costs of the notes borne by you and described on page 2 comprise the cost of issuing, structuring and hedging the notes.

On or prior to the Trade Date, we hedged our anticipated exposure in connection with the notes, by entering into hedging transactions with our subsidiaries and/or third party dealers. We expect our

hedging counterparties to have taken positions in forwards and in futures and options contracts on the euro and U.S. dollar. Such purchase activity could have increased the value of the U.S. dollar relative to the euro on the Trade Date, and, therefore, could have increased the value relative to the euro that the U.S. dollar must attain on the Determination Date so that investors do not suffer a loss on their initial investment in the notes. In addition, through our subsidiaries, we are likely to modify our hedge position throughout the term of the notes by purchasing and selling the U.S. dollar or euro or forwards or options contracts on the U.S. dollar and euro or positions in any other available currencies or instruments that we may wish to use in connection with such hedging activities. As a result, these entities may be unwinding or adjusting hedge positions during the term of the notes, and the hedging strategy may involve greater and more frequent dynamic adjustments to the hedge as the Determination Date approaches. We cannot give any assurance that our hedging activities will not affect the Exchange Rate and, therefore, adversely affect the value of the notes or the payment you will receive at maturity, if any.

Benefit Plan Investor Considerations: Each fiduciary of a pension, profit-sharing or other employee benefit plan subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA") (a "Plan"), should consider the fiduciary standards of ERISA in the context of the Plan's particular circumstances before authorizing an investment in the notes. Accordingly, among other factors, the fiduciary should consider whether the investment would satisfy the prudence and diversification requirements of ERISA and would be consistent with the documents and instruments governing the Plan.

In addition, we and certain of our subsidiaries and affiliates, including MS & Co., may be considered a "party in interest" within the meaning of ERISA, or a "disqualified person" within the meaning of the Internal Revenue Code of 1986, as amended (the "Code"), with respect to many Plans, as well as many individual retirement accounts and Keogh plans (also "Plans"). ERISA Section 406 and Code Section 4975 generally prohibit transactions between Plans and parties in interest or disqualified persons. Prohibited transactions within the meaning of ERISA or the Code would likely arise, for example, if the notes are acquired by or with the assets of a Plan with respect to which MS & Co. or any of its affiliates is a service provider or other party in interest, unless the notes are acquired pursuant to an exemption from the "prohibited transaction" rules. A violation of these "prohibited transaction" rules could result in an excise tax or other liabilities under ERISA and/or Section 4975 of the Code for such persons, unless exemptive relief is available under an applicable statutory or administrative exemption.

The U.S. Department of Labor has issued five prohibited transaction class exemptions ("PTCEs") that may provide exemptive relief for direct or indirect prohibited transactions resulting from the purchase or holding of the notes. Those class exemptions are PTCE 96-23 (for certain transactions determined by in-house asset managers), PTCE 95-60 (for certain transactions involving insurance company general accounts), PTCE 91-38 (for certain transactions involving bank collective investment funds), PTCE 90-1 (for certain transactions involving insurance company separate accounts) and PTCE 84-14 (for certain transactions determined by independent qualified professional asset managers). In addition, ERISA Section 408(b)(17) and Section 4975(d)(20) of the Code may provide an exemption for the purchase and sale of securities and the related lending transactions, provided that neither the Issuer of the notes nor any of its affiliates has or exercises any discretionary authority or control or renders any investment advice with respect to the assets of the Plan involved in the transaction and provided further that the Plan pays no more, and receives no less, than "adequate consideration" in connection with the transaction (the so-called "service provider" exemption). There can be no assurance that any of these class or statutory exemptions will be available with respect to transactions involving the notes.

Because we may be considered a party in interest with respect to many Plans, the notes may not be purchased, held or disposed of by any Plan, any entity whose underlying assets include "plan assets" by reason of any Plan's investment in the entity (a "Plan Asset Entity") or any person investing "plan assets" of any Plan, unless such purchase, holding or disposition is eligible for exemptive relief, including relief available under PTCEs 96-23, 95-60, 91-38, 90-1, 84-14 or the service provider exemption or such purchase, holding or disposition is otherwise not prohibited. Any purchaser, including any fiduciary purchasing on behalf of a Plan, transferee or holder of the notes will be deemed to have represented, in its corporate and its fiduciary capacity, by its purchase and holding of the notes that either (a) it is not a Plan or a Plan Asset Entity and is not purchasing such notes on behalf of or with "plan assets" of any Plan or with any assets of a governmental, non-U.S. or church plan that is subject to any federal, state, local or non-U.S. law that is substantially similar to the provisions of Section 406 of ERISA or Section 4975 of the Code ("Similar Law") or (b) its purchase, holding and disposition are eligible for exemptive relief or such

purchase, holding and disposition are not prohibited by ERISA or Section 4975 of the Code or any Similar Law.

Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt prohibited transactions, it is particularly important that fiduciaries or other persons considering purchasing the notes on behalf of or with "plan assets" of any Plan consult with their counsel regarding the availability of exemptive relief.

The notes are contractual financial instruments. The financial exposure provided by the notes is not a substitute or proxy for, and is not intended as a substitute or proxy for, individualized investment management or advice for the benefit of any purchaser or holder of the notes. The notes have not been designed and will not be administered in a manner intended to reflect the individualized needs and objectives of any purchaser or holder of the notes.

Each purchaser or holder of any notes acknowledges and agrees that:

(i) the purchaser or holder or its fiduciary has made and shall make all investment decisions for the purchaser or holder and the purchaser or holder has not relied and shall not rely in any way upon us or our affiliates to act as a fiduciary or adviser of the purchaser or holder with respect to (A) the design and terms of the notes, (B) the purchaser or holder's investment in the notes, or (C) the exercise of or failure to exercise any rights we have under or with respect to the notes;

(ii) we and our affiliates have acted and will act solely for our own account in connection with (A) all transactions relating to the notes and (B) all hedging transactions in connection with our obligations under the notes;

(iii) any and all assets and positions relating to hedging transactions by us or our affiliates are assets and positions of those entities and are not assets and positions held for the benefit of the purchaser or holder;

(iv) our interests are adverse to the interests of the purchaser or holder; and

(v) neither we nor any of our affiliates is a fiduciary or adviser of the purchaser or holder in connection with any such assets, positions or transactions, and any information that we or any of our affiliates may provide is not intended to be impartial investment advice.

Each purchaser and holder of the notes has exclusive responsibility for ensuring that its purchase, holding and disposition of the notes do not violate the prohibited transaction rules of ERISA or the Code or any Similar Law. The sale of any notes to any Plan or plan subject to Similar Law is in no respect a representation by us or any of our affiliates or representatives that such an investment meets all relevant legal requirements with respect to investments by plans generally or any particular plan, or that such an investment is appropriate for plans generally or any particular plan.

However, individual retirement accounts, individual retirement annuities and Keogh plans, as well as employee benefit plans that permit participants to direct the investment of their accounts, will not be permitted to purchase or hold the notes if the account, plan or annuity is for the benefit of an employee of Morgan Stanley or Morgan Stanley Wealth Management or a family member and the employee receives any compensation (such as, for example, an addition to bonus) based on the purchase of the notes by the account, plan or annuity.

Additional considerations: Client accounts over which Morgan Stanley, Morgan Stanley Wealth Management or any of their respective subsidiaries have investment discretion are not permitted to purchase the notes, either directly or indirectly.

Supplemental information regarding plan of distribution; conflicts of interest: Morgan Stanley expects to agree to sell to MS & Co., and MS & Co. expects to agree to purchase from Morgan Stanley, the aggregate Face Amount of the offered notes specified on the front cover of this pricing supplement. MS & Co. proposes initially to offer the notes to an unaffiliated securities dealer at the price to public set forth on the cover page of this pricing supplement less a concession not in excess of 0.93% of the Face Amount. The price to public for notes purchased by certain fee-based advisory accounts is 99.07% of the Face Amount of the notes, which reduces the agent's commission specified on the cover of this pricing supplement with respect to such notes to 0.00%. MS & Co., the agent for this offering, is our affiliate. Because MS & Co. is both our affiliate and a member of the Financial Industry Regulatory Authority, Inc.

("FINRA"), the underwriting arrangements for this offering must comply with the requirements of FINRA Rule 5121 regarding a FINRA member firm's distribution of the securities of an affiliate and related conflicts of interest. In accordance with FINRA Rule 5121, MS & Co. may not make sales in offerings of the notes to any of its discretionary accounts without the prior written approval of the customer.

MS & Co. is our wholly owned subsidiary and it and other subsidiaries of ours expect to make a profit by selling, structuring and, when applicable, hedging the notes.

MS & Co. will conduct this offering in compliance with the requirements of FINRA Rule 5121 of the Financial Industry Regulatory Authority, Inc., which is commonly referred to as FINRA, regarding a FINRA member firm's distribution of the notes of an affiliate and related conflicts of interest. MS & Co. or any of our other affiliates may not make sales in this offering to any discretionary account. See "Plan of Distribution (Conflicts of Interest)" and "Use of Proceeds and Hedging" in the accompanying prospectus supplement.

Settlement: We expect to deliver the notes against payment for the notes on the Original Issue Date, which will be the fifth scheduled Business Day following the Trade Date. Under Rule 15c6-1 of the Securities Exchange Act of 1934, as amended, trades in the secondary market generally are required to settle in three Business Days, unless the parties to a trade expressly agree otherwise. Accordingly, if the Original Issue Date is more than three Business Days after the Trade Date, purchasers who wish to transact in the notes more than three Business Days prior to the Original Issue Date will be required to specify alternative settlement arrangements to prevent a failed settlement.

Trustee: The Bank of New York Mellon

Calculation Agent: Morgan Stanley Capital Services LLC ("MSCS") and its successors

CUSIP no.: 61760QJQ8

ISIN: US61760QJQ82

HYPOTHETICAL EXAMPLES

The following table and chart are provided for purposes of illustration only. They should not be taken as an indication or prediction of future investment results and are intended merely to illustrate the impact that the various hypothetical Currency Returns on the Determination Date could have on the Cash Settlement Amount.

Any rate of return you may earn on an investment in the notes may be lower than that which you could earn on a comparable investment directly in the Exchange Rate.

The examples below are based on a range of Final Exchange Rates that are entirely hypothetical; no one can predict what the Exchange Rate will be on any day during the term of the notes, and no one can predict what the Exchange Rate will be on the Determination Date. The Exchange Rate has at times experienced periods of high volatility — meaning that the Exchange Rate has changed considerably in relatively short periods — and its performance cannot be predicted for any future period.

The information in the following examples reflects hypothetical rates of return on the notes assuming that they are purchased on the Trade Date at the Face Amount and held to the Stated Maturity Date. The value of the notes at any time after the Trade Date will vary based on many economic and market factors, including interest rates, the volatility of the Exchange Rate, our creditworthiness and changes in market conditions, and cannot be predicted with accuracy. Any sale prior to the Stated Maturity Date could result in a substantial loss to you.

Key Terms and Assumptions	
Face Amount:	$1,000
Upside Participation Rate:	137%
Initial Exchange Rate:	1.15135
Minimum Cash Settlement Amount:	None

- *Notes purchased on the Original Issue Date at the Face Amount and held to the Stated Maturity Date.*

The actual performance of the Exchange Rate over the term of the notes, as well as the Cash Settlement Amount, if any, may bear little relation to the hypothetical examples shown below or to the historical levels of the Exchange Rate shown elsewhere in this document. For information about the historical levels of the Exchange Rate during recent periods, see “The Exchange Rate” below.

The levels in the left column of the table below represent hypothetical Final Exchange Rates assuming the Initial Exchange Rate of 1.15135 (i.e., 1.15135 U.S. dollars are needed to buy one euro). The levels in the middle column of the table below represent hypothetical Currency Returns. The amounts in the right column represent the hypothetical Cash Settlement Amount, based on the corresponding hypothetical Currency Return, and are expressed as percentages of the Face Amount of a note (rounded to the nearest one-thousandth of one percent). Thus, a hypothetical Cash Settlement Amount of 100% means that the value of the cash payment that we would deliver for each $1,000 Face Amount of notes on the Stated Maturity Date would equal 100% of the Face Amount of notes, based on the corresponding hypothetical Currency Return and the assumptions noted above. The numbers appearing in the table and chart below may have been rounded for ease of analysis.

The Final Exchange Rate will be determined on the Determination Date. The Currency Return will be equal to the *quotient* of (1) the Initial Exchange Rate *minus* the Final Exchange Rate *divided* by (2) the Initial Exchange Rate, expressed as a positive or negative percentage.

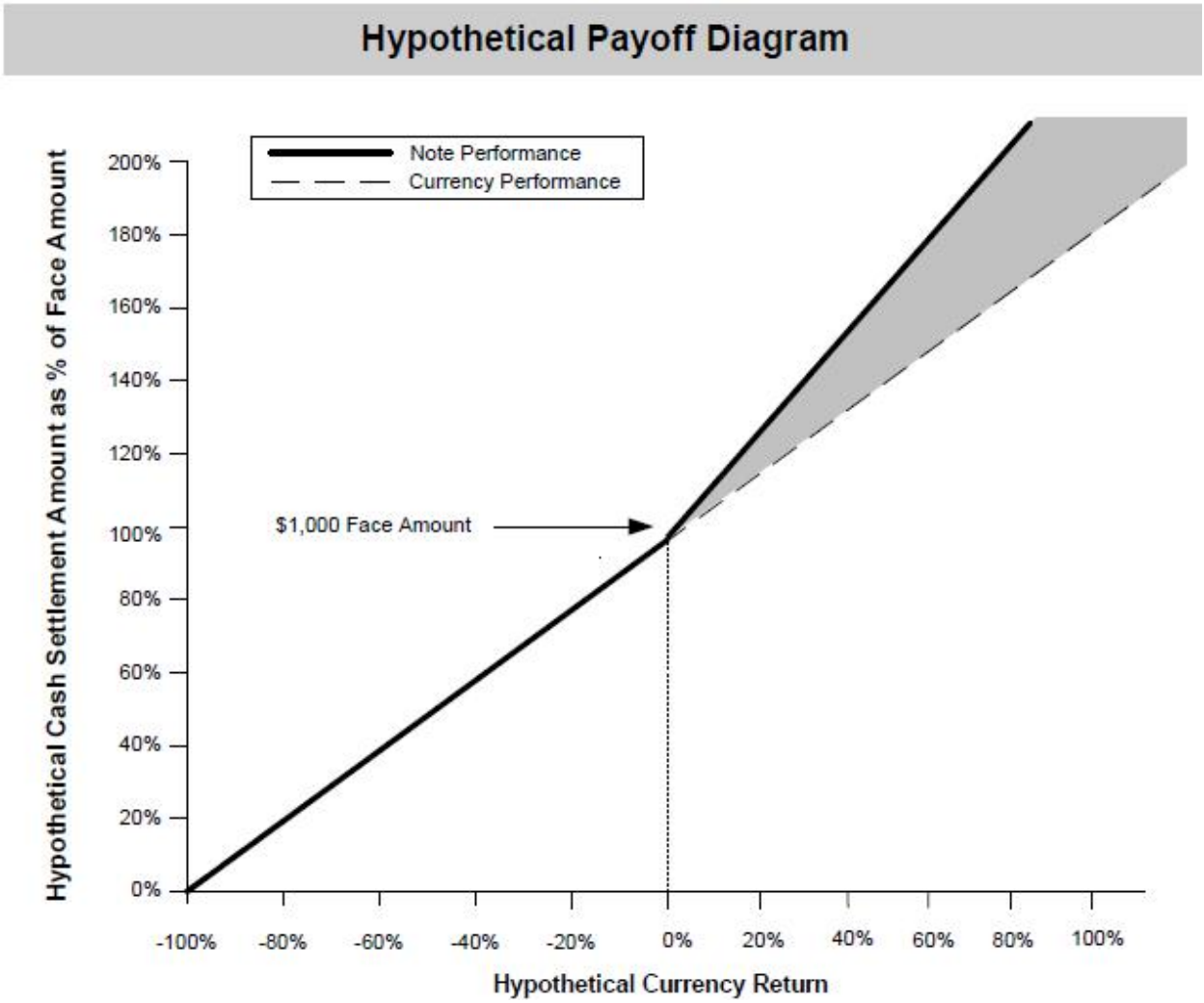
Hypothetical Final Exchange Rate (Expressed as Number of U.S. Dollars Per One Euro)	Hypothetical Currency Return	Hypothetical Cash Settlement Amount (as Percentage of Face Amount)
0.57568	50.000%	168.499%
0.86351	25.000%	134.250%
0.97865	15.000%	120.550%
1.03622	10.000%	113.699%
1.09378	5.000%	106.850%
1.15135	0.000%	100.000%
1.15136	-0.001%	99.999%
1.20892	-5.000%	95.000%
1.26649	-10.000%	90.000%
1.38162	-20.000%	80.000%
1.43919	-25.000%	75.000%
1.72703	-50.000%	50.000%
2.01486	-75.000%	25.000%
2.30270	-100.000%	0.000%

If, for example, the Currency Return were determined to be -75.000%, the Cash Settlement Amount would be 25.000% of the Face Amount of notes, as shown in the table above. As a result, if you purchased your notes on the Original Issue Date at the Face Amount and held them to the Stated Maturity Date, you would lose 75.000% of your investment. If you purchased your notes at a premium to the Face Amount, you would lose a correspondingly higher percentage of your investment.

If the Currency Return were determined to be 25.000%, the Cash Settlement Amount would be 134.250% of each $1,000 Face Amount of notes, as shown in the table above.

Payoff Diagram

The following chart shows a graphical illustration of the hypothetical Cash Settlement Amount (expressed as a percentage of the Face Amount of notes), if the Currency Return were any of the hypothetical amounts shown on the horizontal axis. The chart shows that any hypothetical Currency Return of less than 0% (the section to the left of the 0% marker on the horizontal axis) would result in a hypothetical Cash Settlement Amount of less than 100% of the Face Amount of notes (the section below the 100% marker on the vertical axis) and, accordingly, in a loss of principal to the holder of the notes.



RISK FACTORS

The following is a non-exhaustive list of certain key risk factors for investors in the notes. For further discussion of these and other risks, you should read the section entitled "Risk Factors" in the accompanying prospectus supplement and prospectus. We also urge you to consult your investment, legal, tax, accounting and other advisers in connection with your investment in the notes.

The Notes Do Not Pay Interest Or Guarantee The Return Of Any Of Your Principal

The terms of the notes differ from those of ordinary debt securities in that the notes do not pay interest and do not guarantee any return of principal at maturity. If the Currency Return is less than 0%, you will receive for each note that you hold a Cash Settlement Amount that is less than the Face Amount of each note by an amount proportionate to the full negative Currency Return, calculated as described herein. As there is no minimum Cash Settlement Amount on the notes, you could lose your entire initial investment.

Also, the market price of your notes prior to the Stated Maturity Date may be significantly lower than the purchase price you pay for your notes. Consequently, if you sell your notes before the Stated Maturity Date, you may receive significantly less than the amount of your investment in the notes.

The Notes Are Subject To Currency Exchange Risk

As more fully described below, fluctuations in the Exchange Rate between the U.S. dollar and the euro will affect the value of the notes. The Exchange Rate between the U.S. dollar and the euro is volatile and is the result of numerous factors specific to the United States and the Eurozone, including the supply of, and the demand for, the euro, as well as government policy, intervention or actions, but is also influenced significantly from time to time by political or economic developments, and by macroeconomic factors and speculative actions related to different regions. Changes in the Exchange Rate result over time from the interaction of many factors directly or indirectly affecting economic and political conditions in the United States and the Eurozone, including economic and political developments in other countries. Of particular importance to potential currency exchange risk are: (i) existing and expected rates of inflation; (ii) existing and expected interest rate levels; (iii) the balance of payments; and (iv) the extent of governmental surpluses or deficits in the United States and the Eurozone. All of these factors are in turn sensitive to the monetary, fiscal and trade policies pursued by the governments of the United States, the European Union and other countries important to international trade and finance. The weakening of the U.S. dollar relative to the euro will have a material adverse effect on the value of the notes and the return on an investment in the notes.

Government Intervention In The Currency Markets Could Materially And Adversely Affect The Value Of The Notes

Specific currencies' exchange rates can be highly volatile and are affected by numerous factors specific to each foreign country. Foreign currency exchange rates can be fixed by the sovereign government, allowed to float within a range of exchange rates set by the government, or left to float freely. Governments, including those of the United States and the European Union, may use a variety of techniques, such as intervention by their central bank or the imposition of regulatory controls or taxes, to affect the exchange rates of their respective currencies. They may also issue a new currency to replace an existing currency, fix the exchange rate or alter the exchange rate or relative exchange characteristics by devaluation or revaluation of a currency. Thus, a special risk in purchasing the notes is that their liquidity, trading value and amount payable could be affected by the actions of sovereign governments that could change or interfere with previously freely determined currency valuations, fluctuations in response to other market forces and the movement of currencies across borders. There will be no offsetting adjustment or change made during the term of the notes in the event that the floating Exchange Rate between the U.S. dollar and the euro should become fixed. Nor will there be any offsetting adjustment or change in the event of any other devaluation or revaluation or imposition of exchange or other regulatory controls or taxes or in the event of other developments affecting the euro, or any other currency. Therefore, any significant changes or governmental actions with respect to the U.S. dollar, the euro or any other currency that result in the weakening of the U.S. dollar relative to the euro may have a material adverse effect on the value of the notes and the return on an investment in the notes.

In addition, if the euro is lawfully eliminated, converted, redenominated or exchanged by the European Union during the term of the notes, the Calculation Agent, in its sole discretion, will determine the Exchange Rate for the euro (or make such adjustment to the Exchange Rate, as required) on the Determination Date and this determination may adversely affect the payment on the notes.

Even Though Currencies Trade Around The Clock, The Notes Will Not

The interbank market in foreign currencies is a global, around-the-clock market. Therefore, the hours of trading for the notes, if any trading market develops, will not conform to the hours during which the U.S. dollar and the euro are traded. Significant price and rate movements may take place in the underlying foreign exchange markets that will not be reflected immediately in the price of the notes. The possibility of these movements should be taken into account in relating the value of the notes to those in the underlying foreign exchange markets. There is no systematic reporting of last-sale information for foreign currencies. Reasonably current bid and offer information is available in certain brokers' offices, in bank foreign currency trading offices and to others who wish to subscribe for this information, but this information will not necessarily be reflected in the Exchange Rate between the U.S. dollar and the euro used to calculate the currency performance. There is no regulatory requirement that those quotations be firm or revised on a timely basis. The absence of last-sale information and the limited availability of quotations to individual investors may make it difficult for many investors to obtain timely, accurate data about the state of the underlying foreign exchange markets.

Suspension Or Disruptions Of Market Trading In The Euro May Adversely Affect The Value Of The Notes

The currency markets are subject to temporary distortions or other disruptions due to various factors, including government regulation and intervention, the lack of liquidity in the markets, and the participation of speculators. These circumstances could adversely affect the exchange rate of between the U.S. dollar and the euro and, therefore, the value of the notes.

If The Euro Ceases To Exist, The Calculation Agent Will Determine The Currency Return

In light of recent events affecting European economies, including the sovereign debt crises in Greece, Italy and other countries included in the euro area, it is not certain that the euro will continue to exist on the Determination Date. In the event that the euro is lawfully eliminated or converted into or exchanged for one or more other currencies, the Calculation Agent, which is an affiliate of ours, will determine the Exchange Rate and Currency Return (or make an adjustment to the Initial Exchange Rate), in its sole discretion. Although the Calculation Agent will act in good faith and use its reasonable judgment in making this determination, it may have a conflict of interest in doing so and it will have no obligation to make the determination in the manner that is most, or at all, advantageous to holders of the notes. If the euro ceases to exist and the Calculation Agent is required to make this determination, the amount payable on the notes may be adversely affected.

The Currency Return Formula Will Diminish Any Appreciation And Magnify Any Depreciation Of The U.S. Dollar Relative To The Euro

The Currency Return will be calculated by subtracting the Final Exchange Rate from the Initial Exchange Rate and dividing the result by the Initial Exchange Rate and expressing the result as a percentage. Because the Currency Return is calculated by dividing by the Initial Exchange Rate, rather than by the Final Exchange Rate, the effect on the Currency Return of any appreciation of the U.S. dollar relative to the euro will be diminished, while the effect on the Currency Return of any depreciation of the U.S. dollar relative to the euro will be magnified. For example, assuming a hypothetical Initial Exchange Rate of 1.10, if the Final Exchange Rate were 0.88 (meaning that the U.S. dollar has appreciated relative to the euro such that it takes fewer dollars to purchase one euro), the Currency Return, calculated as set forth herein, would be equal to 20%, whereas it would be 25% if it were instead calculated using a formula that divides by the Final Exchange Rate. Additionally, if the Final Exchange Rate were 1.32 (meaning that the U.S. dollar has depreciated relative to the euro such that it takes more dollars to purchase one euro), the Currency Return, calculated as set forth herein, would be equal to -20%, whereas it would be approximately -16.67% if it were instead calculated using a formula that divides by the Final Exchange Rate.

Due To The Currency Return Formula, The Cash Settlement Amount For The Notes Is Limited

Due to the Currency Return formula, the Cash Settlement Amount cannot be greater than $2,370 for each $1,000 Face Amount of your notes, as the Currency Return can never exceed 100%.

If You Purchase Your Notes At A Premium To The Face Amount, The Return On Your Investment Will Be Lower Than The Return On Notes Purchased At The Face Amount, And The Impact Of Certain Key Terms Of The Notes Will Be Negatively Affected

The Cash Settlement Amount will not be adjusted based on the issue price you pay for the notes. If you purchase notes at a price that differs from the Face Amount of notes, then the return on your investment in such notes held to the Stated Maturity Date will differ from, and may be substantially less than, the return on notes purchased at the Face Amount. If you purchase your notes at a premium to the Face Amount and hold them to the Stated Maturity Date, the return on your investment in the notes will be lower than it would have been had you purchased the notes at the Face Amount or at a discount to the Face Amount.

The Market Price Will Be Influenced By Many Unpredictable Factors

Several factors, many of which are beyond our control, will influence the value of the notes in the secondary market and the price at which MS & Co. may be willing to purchase or sell the notes in the secondary market, including: the level of the Exchange Rate, volatility (frequency and magnitude of changes in value) of the Exchange Rate, interest and yield rates in the U.S. and in the Eurozone, time remaining to maturity, geopolitical conditions and economic, financial, political and regulatory or judicial events that affect the U.S. dollar, the euro or currency markets generally and which may affect the Final Exchange Rate and any actual or anticipated changes in our credit ratings or credit spreads. The level of the Exchange Rate may be, and has been, volatile, and we can give you no assurance that the volatility will lessen. See “Historical Exchange Rates” below. You may receive less, and possibly significantly less, than the Face Amount per note if you try to sell your notes prior to maturity.

The Notes Are Subject To The Credit Risk Of Morgan Stanley, And Any Actual Or Anticipated Changes To Its Credit Ratings Or Credit Spreads May Adversely Affect The Market Value Of The Notes

You are dependent on Morgan Stanley’s ability to pay all amounts due on the notes at maturity, and therefore you are subject to the credit risk of Morgan Stanley. If Morgan Stanley defaults on its obligations under the notes, your investment would be at risk and you could lose some or all of your investment. As a result, the market value of the notes prior to maturity will be affected by changes in the market’s view of Morgan Stanley’s creditworthiness. Any actual or anticipated decline in Morgan Stanley’s credit ratings or increase in the credit spreads charged by the market for taking Morgan Stanley credit risk is likely to adversely affect the market value of the notes.

The Amount Payable On The Notes Is Not Linked To The Level Of The Exchange Rate At Any Time Other Than The Determination Date

The amount payable on the notes at maturity will be based on the Final Exchange Rate. Even if the U.S. dollar appreciates relative to the euro (i.e., the Exchange Rate decreases) prior to the Determination Date but then depreciates (i.e., the Exchange Rate increases) by the Determination Date, the Cash Settlement Amount will be less, and may be significantly less, than it would have been had the Cash Settlement Amount been linked to the performance of the U.S. dollar relative to the euro prior to such depreciation. Although the actual Exchange Rate on the Stated Maturity Date or at other times during the term of the notes may be lower than the the Final Exchange Rate, the payout on the notes will be based solely on the Exchange Rate on the Determination Date.

Investing In The Notes Is Not Equivalent To Investing In U.S. Dollar Relative To The Euro

Investing in the notes is not equivalent to investing directly in the U.S. dollar relative to the euro. You may receive a lower payment at maturity than you would have received if you had invested directly in the U.S. dollar relative to the euro. The Currency Return is dependent solely on the formula stated above and not on any other formula that could be used for calculating currency returns.

The Rate We Are Willing To Pay For Securities Of This Type, Maturity And Issuance Size Is Likely To Be Lower Than The Rate Implied By Our Secondary Market Credit Spreads And Advantageous

To Us. Both The Lower Rate And The Inclusion Of Costs Associated With Issuing, Selling, Structuring And Hedging The Notes In The Original Issue Price Reduce The Economic Terms Of The Notes, Cause The Estimated Value Of The Notes To Be Less Than The Original Issue Price And Will Adversely Affect Secondary Market Prices

Assuming no change in market conditions or any other relevant factors, the prices, if any, at which dealers, including MS & Co., may be willing to purchase the notes in secondary market transactions will likely be significantly lower than the Original Issue Price, because secondary market prices will exclude the issuing, selling, structuring and hedging-related costs that are included in the Original Issue Price and borne by you and because the secondary market prices will reflect our secondary market credit spreads and the bid-offer spread that any dealer would charge in a secondary market transaction of this type as well as other factors.

The inclusion of the costs of issuing, selling, structuring and hedging the notes in the Original Issue Price and the lower rate we are willing to pay as issuer make the economic terms of the notes less favorable to you than they otherwise would be.

However, because the costs associated with issuing, selling, structuring and hedging the notes are not fully deducted upon issuance, for a period of up to 6 months following the issue date, to the extent that MS & Co. may buy or sell the notes in the secondary market, absent changes in market conditions, including those related to the Exchange Rate, and to our secondary market credit spreads, it would do so based on values higher than the estimated value, and we expect that those higher values will also be reflected in your brokerage account statements.

The Estimated Value Of The Notes Is Determined By Reference To Our Pricing And Valuation Models, Which May Differ From Those Of Other Dealers And Is Not A Maximum Or Minimum Secondary Market Price

These pricing and valuation models are proprietary and rely in part on subjective views of certain market inputs and certain assumptions about future events, which may prove to be incorrect. As a result, because there is no market-standard way to value these types of securities, our models may yield a higher estimated value of the notes than those generated by others, including other dealers in the market, if they attempted to value the notes. In addition, the estimated value on the Trade Date does not represent a minimum or maximum price at which dealers, including MS & Co., would be willing to purchase your notes in the secondary market (if any exists) at any time. The value of your notes at any time after the date hereof will vary based on many factors that cannot be predicted with accuracy, including our creditworthiness and changes in market conditions. See also “The Market Price Will Be Influenced By Many Unpredictable Factors” above.

The Notes Will Not Be Listed On Any Securities Exchange And Secondary Trading May Be Limited

The notes will not be listed on any securities exchange. Therefore, there may be little or no secondary market for the notes. MS & Co. may, but is not obligated to, make a market in the notes and, if it once chooses to make a market, may cease doing so at any time. When it does make a market, it will generally do so for transactions of routine secondary market size at prices based on its estimate of the current value of the notes, taking into account its bid/offer spread, our credit spreads, market volatility, the notional size of the proposed sale, the cost of unwinding any related hedging positions, the time remaining to maturity and the likelihood that it will be able to resell the notes. Even if there is a secondary market, it may not provide enough liquidity to allow you to trade or sell the notes easily. Since other broker-dealers may not participate significantly in the secondary market for the notes, the price at which you may be able to trade your notes is likely to depend on the price, if any, at which MS & Co. is willing to transact. If, at any time, MS & Co. were to cease making a market in the notes, it is likely that there would be no secondary market for the notes. Accordingly, you should be willing to hold your notes to maturity.

The Calculation Agent, Which Is A Subsidiary Of The Issuer, Will Make Determinations With Respect To The Notes

As Calculation Agent, MSCS has determined the Initial Exchange Rate, will determine the Final Exchange Rate and the Currency Return, and will calculate the Cash Settlement Amount. Any of these determinations made by MSCS, in its capacity as the Calculation Agent, including with respect to the

determination of the Exchange Rate in the event of an elimination of, or a discontinuance of, reporting of the Exchange Rate, may adversely affect the payout to you.

Hedging And Trading Activity By Our Subsidiaries Could Potentially Adversely Affect The Value Of The Notes

One or more of our subsidiaries and/or third-party dealers have carried out, and will continue to carry out, hedging activities related to the notes, including trading in futures, forwards and/or options contracts on the euro; as well as in other instruments related to the U.S. dollar and/or euro. As a result, these entities may be unwinding or adjusting hedge positions during the term of the notes, and the hedging strategy may involve greater and more frequent dynamic adjustments to the hedge as the Determination Date approaches. Some of our subsidiaries also trade the euro and other financial instruments related to the euro on a regular basis as part of their general broker-dealer, proprietary trading and other businesses. Any of these hedging or trading activities on or prior to the Trade Date could have increased the value of the U.S. dollar relative to the euro on the Trade Date and, as a result, could have increased the value relative to the euro that the U.S. dollar must attain on the Determination Date so that you do not suffer a loss on your initial investment in the notes. Additionally, such hedging or trading activities during the term of the notes could potentially affect the Exchange Rate on the Determination Date and the Cash Settlement Amount you will receive at maturity, if any. Furthermore, if the dealer from which you purchase notes is to conduct trading and hedging activities for us in connection with the notes, that dealer may profit in connection with such trading and hedging activities, and such profit, if any, will be in addition to the compensation that the dealer receives for the sale of the notes to you. You should be aware that the potential to earn a profit in connection with hedging activities may create a further incentive for the dealer to sell the notes to you, in addition to the compensation they would receive for the sale of the notes.

We May Sell An Additional Aggregate Face Amount Of Notes At A Different Issue Price

At our sole option, we may decide to sell an additional aggregate Face Amount of notes subsequent to the date hereof. The issue price of the notes in the subsequent sale may differ substantially (higher or lower) from the issue price you paid as provided on the cover of this document.

Past Performance is No Guide to Future Performance

The actual performance of the Exchange Rate over the term of the notes, as well as the amount payable at maturity, may bear little relation to the historical Exchange Rates or to the hypothetical return examples set forth herein. We cannot predict the future performance of the Exchange Rate.

The U.S. Federal Income Tax Consequences Of An Investment In The Notes Are Uncertain

Please read the discussion under "—Additional provisions—Tax considerations" in this document and the discussion under "United States Federal Taxation" in the accompanying prospectus supplement (together the "Tax Disclosure Sections") concerning the U.S. federal income tax consequences of an investment in the notes. If the Internal Revenue Service (the "IRS") were successful in asserting an alternative treatment, the timing and character of income on the notes might differ significantly from the tax treatment described in the Tax Disclosure Sections. For example, under one possible treatment, the IRS could seek to recharacterize the notes as contingent payment debt instruments. In that event, U.S. Holders would be required to accrue into income original issue discount on the notes every year at a "comparable yield" determined at the time of issuance and recognize all income and gain in respect of the notes as ordinary income. In addition, in 2007, the IRS issued a revenue ruling holding that a financial instrument, which is issued and redeemed for U.S. dollars, but provides a return determined by reference to a foreign currency and related market interest rates, is a debt instrument denominated in the foreign currency. While the notes are distinguishable in meaningful respects from the instrument described in the revenue ruling, future guidance that extends the scope of the revenue ruling could materially and adversely affect the tax consequences of an investment in the notes for U.S. Holders, possibly with retroactive effect. As discussed under "United States Federal Taxation—FATCA Legislation" in the accompanying prospectus supplement, the withholding rules commonly referred to as "FATCA" would apply to the notes if the notes were recharacterized as debt instruments. We do not plan to request a ruling from the IRS regarding the tax treatment of the notes, and the IRS or a court may not agree with the tax treatment described in the Tax Disclosure Sections.

Alternatively, the IRS could assert that a note constitutes a “Section 1256 contract” that is subject to the “mark-to-market” rule under Section 1256 of the Internal Revenue Code of 1986, as amended (the “Code”), in which case a U.S. Holder would recognize gain or loss in each year as if the note, or portion thereof, were sold for its fair market value on the last business day of the year.

In 2007, the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of “prepaid forward contracts” and similar instruments. The notice focuses in particular on whether to require holders of these instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; whether short-term instruments should be subject to any such accrual regime; the relevance of factors such as the exchange-traded status of the instruments and the nature of the underlying property to which the instruments are linked; the degree, if any, to which income (including any mandated accruals) realized by non-U.S. investors should be subject to withholding tax; and whether these instruments are or should be subject to the “constructive ownership” rule, which very generally can operate to recharacterize certain long-term capital gain as ordinary income and impose an interest charge. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the notes, possibly with retroactive effect.

Both U.S. and non-U.S. Holders should consult their tax advisers regarding the U.S. federal income tax consequences of an investment in the notes, including possible alternative treatments, the potential application of Section 1256 of the Code, the issues presented by this notice and revenue ruling, and any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

HISTORICAL EXCHANGE RATES

We have derived all information regarding the Exchange Rate contained in this pricing supplement from publicly available information, without independent verification.

The Exchange Rate has fluctuated in the past and may, in the future, experience significant fluctuations. Any historical upward or downward trend in the Exchange Rate during any period shown below is not an indication that the Exchange Rate is more or less likely to increase or decrease at any time during the life of your notes. You should not take the historical Exchange Rates as an indication of future performance. We cannot give you any assurance that the future performance of the Exchange Rate will not result in a loss of some or all of your investment in the notes.

The actual performance of the Exchange Rate over the term of the notes, as well as the Cash Settlement Amount at maturity, may bear little relation to the historical Exchange Rates shown below.

The following table sets forth the published high, low and end of quarter daily Exchange Rates for each of the four calendar quarters in, 2013, 2014, 2015 and the first two calendar quarters in 2016 (through May 2, 2016). The following graph sets forth the daily exchange rate of the U.S. dollar relative to the euro during the same period. As set forth in the table and graph below, a decrease in the Exchange Rate for a given period indicates a positive Currency Return, while an increase in the Exchange Rate indicates a negative Currency Return. We obtained the information in the table and graph below from Bloomberg Financial Markets (“Bloomberg”) without independent verification. We will not use Bloomberg to determine the applicable Exchange Rates. The historical Exchange Rates set forth below should not be taken as an indication of future performance. We cannot give you any assurance that the Cash Settlement Amount at maturity will not result in a loss of some or all of your investment in the notes.

Quarterly High, Low and Period End Exchange Rates of U.S. Dollar versus Euro

(expressed as the number of U.S. dollars needed to buy one euro)

	High	Low	Period End
2013			
First Quarter	1.3640	1.2853	1.2819
Second Quarter	1.3392	1.2820	1.3010
Third Quarter	1.3530	1.2781	1.3527
Fourth Quarter	1.3802	1.3367	1.3743
2014			
First Quarter	1.3934	1.3486	1.3769
Second Quarter	1.3928	1.3532	1.3692
Third Quarter	1.3679	1.2684	1.2631
Fourth Quarter	1.2838	1.2623	1.2098
2015			
First Quarter	1.2104	1.0496	1.0731
Second Quarter	1.1451	1.0567	1.1147
Third Quarter	1.1619	1.0825	1.1177
Fourth Quarter	1.1474	1.0565	1.0862
2016			
First Quarter	1.1338	1.0748	1.1380
Second Quarter (through May 2, 2016)	1.1518	1.1222	1.1518


1.7000
1.6000
1.5000
1.4000
1.3000
1.2000
1.1000
1.0000
0.9000
0.8000
1/1/2006
1/1/2007
1/1/2008
1/1/2009
1/1/2010
1/1/2011
1/1/2012
1/1/2013
1/1/2014
1/1/2015
1/1/2016

TAX CONSIDERATIONS

Although there is uncertainty regarding the U.S. federal income tax consequences of an investment in the notes due to the lack of governing authority, we intend to treat each note as a single financial contract that is an "open transaction" for U.S. federal income tax purposes. In the opinion of our counsel, Davis Polk & Wardwell LLP, this treatment of the notes is reasonable under current law; however, our counsel has advised us that it is unable to conclude affirmatively that this treatment is more likely than not to be upheld, and that alternative treatments are possible.

Assuming this treatment of the notes is respected and subject to the discussion in "United States Federal Taxation" in the accompanying prospectus supplement, the following U.S. federal income tax consequences should result based on current law:

- A U.S. Holder should not be required to recognize taxable income over the term of the notes prior to settlement, other than pursuant to a sale or exchange.

- Upon sale, exchange or settlement of the notes, a U.S. Holder should recognize gain or loss equal to the difference between the amount realized and the U.S. Holder's tax basis in the notes. Because the payment on the notes is linked to a foreign currency, it is likely that the notes will be subject to Section 988 of the Code. In that case, any gain or loss generally will be treated as ordinary income or loss. While a taxpayer may elect to treat gain or loss on certain forward contracts, futures contracts and option contracts linked to one or more foreign currencies as capital gain or loss, it is unclear whether the election is available for the notes.

Because the notes are linked to a single foreign currency in which positions are traded through regulated futures contracts, there is a possibility that an investment in the notes will constitute a "Section 1256 contract." U.S. Holders should read the section entitled "United States Federal Taxation—Tax Consequences to U.S. Holders—Possible Application of Section 1256 of the Code" in the accompanying prospectus supplement.

In 2007, the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. The notice focuses in particular on whether to require holders of these instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; whether short-term instruments should be subject to any such accrual regime; the relevance of factors such as the exchange-traded status of the instruments and the nature of the underlying property to which the instruments are linked; the degree, if any, to which income (including any mandated accruals) realized by non-U.S. investors should be subject to withholding tax; and whether these instruments are or should be subject to the "constructive ownership" rule, which very generally can operate to recharacterize certain long-term capital gain as ordinary income and impose an interest charge. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the notes, possibly with retroactive effect.

In 2007, the IRS also issued a revenue ruling holding that a financial instrument, which is issued and redeemed for U.S. dollars but provides a return determined by reference to a foreign currency and related market interest rates, is a debt instrument denominated in the foreign currency. While the notes are distinguishable in meaningful respects from the instrument described in the revenue ruling, future guidance that extends the scope of the revenue ruling could materially and adversely affect the tax consequences of an investment in the notes for U.S. Holders, possibly with retroactive effect.

Both U.S. and non-U.S. investors considering an investment in the notes should read the discussion under "Risk Factors" in this document and the discussion under "United States Federal Taxation" in the accompanying prospectus supplement and consult their tax advisers regarding all aspects of the U.S. federal income tax consequences of an investment in the notes,

including the potential application of Section 1256 of the Code and other possible alternative treatments, the issues presented by the aforementioned notice and revenue ruling, and any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

The discussion in the preceding paragraphs under "Tax considerations" and the discussion contained in the section entitled "United States Federal Taxation" in the accompanying prospectus supplement, insofar as they purport to describe provisions of U.S. federal income tax laws or legal conclusions with respect thereto, constitute the full opinion of Davis Polk & Wardwell LLP regarding the material U.S. federal tax consequences of an investment in the notes.

CONTACT

Morgan Stanley clients may contact their local Morgan Stanley branch office or our principal executive offices at 1585 Broadway, New York, New York 10036 (telephone number (866) 477-4776). All other clients may contact their local brokerage representative. Third-party distributors may contact Morgan Stanley Structured Investment Sales at (800) 233-1087.

WHERE YOU CAN FIND MORE INFORMATION

Morgan Stanley has filed a registration statement (including a prospectus, as supplemented by the prospectus supplement) with the Securities and Exchange Commission, or SEC, for the offering to which this communication relates. You should read the prospectus in that registration statement, the prospectus supplement and any other documents relating to this offering that Morgan Stanley has filed with the SEC for more complete information about Morgan Stanley and this offering. You may get these documents without cost by visiting EDGAR on the SEC web site at www.sec.gov. Alternatively, Morgan Stanley will arrange to send you the prospectus supplement and prospectus if you so request by calling toll-free 800-584-6837.

You may access these documents on the SEC web site at www.sec.gov.as follows:

Prospectus Supplement dated November 19, 2014

Prospectus dated February 16, 2016

Terms used but not defined in this document are defined in the prospectus supplement or in the prospectus. As used in this document, the “Company,” “we,” “us” and “our” refer to Morgan Stanley.

VALIDITY OF THE NOTES

In the opinion of Davis Polk & Wardwell LLP, as special counsel to Morgan Stanley, when the notes offered by this pricing supplement have been executed and issued by Morgan Stanley, authenticated by the trustee pursuant to the Senior Debt Indenture and delivered against payment as contemplated herein, such notes will be valid and binding obligations of Morgan Stanley, enforceable in accordance with their terms, subject to applicable bankruptcy, insolvency and similar laws affecting creditors’ rights generally, concepts of reasonableness and equitable principles of general applicability (including, without limitation, concepts of good faith, fair dealing and the lack of bad faith), provided that such counsel expresses no opinion as to the effect of fraudulent conveyance, fraudulent transfer or similar provision of applicable law on the conclusions expressed above. This opinion is given as of the date hereof and is limited to the laws of the State of New York and the General Corporation Law of the State of Delaware. In addition, this opinion is subject to customary assumptions about the trustee’s authorization, execution and delivery of the Senior Debt Indenture and its authentication of the notes and the validity, binding nature and enforceability of the Senior Debt Indenture with respect to the trustee, all as stated in the letter of such counsel dated February 16, 2016, which is Exhibit 5-a to Post-Effective Amendment No. 1 to the Registration Statement on Form S-3 filed by Morgan Stanley on February 16, 2016.

$250,000,000
iPath® EUR/USD Exchange Rate ETN

The iPath® Exchange Traded Notes due May 14, 2037 (the "Securities") are linked to the euro / U.S. dollar exchange rate, do not guarantee any return of principal at maturity and do not pay any interest during their term. Instead, you will receive a cash payment at maturity or upon early redemption based on the performance of the euro / U.S. dollar exchange rate, an accumulation component and an investor fee.

You may lose some or all of your principal if you invest in the Securities. Any payment on the Securities at or prior to maturity is subject to the creditworthiness of Barclays Bank PLC and is not guaranteed by any third party. See "Risk Factors" beginning on page PS-10 of this pricing supplement for risks relating to an investment in the Securities.

The principal terms of the Securities are as follows:

Issuer: Barclays Bank PLC

Series: Global Medium-Term Notes, Series A

Inception Date: May 8, 2007.

CUSIP Number: 06739F184

ISIN: GB00B1WPBD95

Underlying Index: The return on the Securities is linked to the performance of the euro / U.S. dollar exchange rate (the "EUR/USD exchange rate" or the "Index"). The EUR/USD exchange rate is a foreign exchange spot rate that measures the relative values of two currencies, the euro and the U.S. dollar. When the euro appreciates relative to the U.S. dollar, the EUR/USD exchange rate (and the value of the Securities) increases; when the euro depreciates relative to the U.S. dollar, the EUR/USD exchange rate (and the value of the Securities) decreases. The EUR/USD exchange rate is expressed as a rate that reflects the number of U.S. dollars that can be exchanged for one euro in the interbank market for settlement in two days. From and including the inception date to and including December 17, 2008, the EUR/USD exchange rate is the rate reported each day shortly after 10:00 a.m. on Reuters page 1FED. Due to the announcement by the Federal Reserve Bank of New York that it would discontinue the publication of foreign exchange rates on December 31, 2008, after December 17, 2008 the EUR/USD exchange rate is the rate reported each day on Bloomberg screen EURUSD WMCO Curncy <GO> at approximately 4 p.m., London time, or any successor page.

Payment at Maturity: If you hold your Securities to maturity, you will receive a cash payment equal to (1) the principal amount of your Securities *times* (2) the index factor on the final valuation date *minus* (3) the investor fee on the final valuation date.

Secondary Market: We have listed the Securities on the NYSE Arca stock exchange ("NYSE Arca") under the ticker symbol ERO. If an active secondary market in the Securities exists, we expect that investors will purchase and sell the Securities primarily in this secondary market. We are not required to maintain any listing of the Securities on NYSE Arca or any other securities exchange.

Early Redemption: Subject to the notification requirements described in this pricing supplement, you may redeem your Securities on any redemption date during the term of the Securities. If you redeem your Securities, you will receive a cash payment in an amount equal to the daily redemption value, which equals (1) the principal amount of your Securities *times* (2) the index factor on the applicable valuation date *minus* (3) the investor fee on the applicable valuation date. You must redeem at least 50,000 Securities at one time in order to exercise your right to redeem your Securities on any redemption date.

Redemption Mechanics: In order to redeem your Securities on a redemption date, you must deliver a notice of redemption to us via email by no later than 4:00 p.m., New York City time, on the business day prior to the applicable valuation date and follow the procedures set forth under "Specific Terms of the Securities – Redemption Procedures". If you fail to comply with these procedures, your notice will be deemed ineffective.

Valuation Date: Valuation date means each business day from May 17, 2007 to May 7, 2037, inclusive or, if such date is not a trading day, the next succeeding trading day, not to exceed five business days. We refer to Thursday, May 7, 2037, as the "final valuation date".

Redemption Date: A redemption date is the third business day following each valuation date (other than the final valuation date). The final redemption date will be the third business day following the valuation date that is immediately prior to the final valuation date.

Currency Component: The currency component on any given day will be equal to the EUR/USD exchange rate on that day (or, if such day is not a trading day, the EUR/USD exchange rate on the immediately preceding trading day) *divided by* the EUR/USD exchange rate on the inception date.

Accumulation Component: The accumulation component will be calculated on a daily basis in the following manner: The accumulation component on the inception date will equal one. On each subsequent business day until maturity or early redemption, the accumulation component will equal (1) the accumulation component on the immediately preceding business day *times* (2) the sum of one *plus* the product of the deposit rate *times* the relevant daycount fraction.

Index Factor: The index factor on any given day will be equal to the currency component on that day *times* the accumulation component on that day.

Deposit Rate: The deposit rate on any given day will be equal to the European Overnight Index Average, as reported on Reuters page EONIA or any successor page on the immediately preceding business day (the "EONIA"), *minus* 0.25%. The deposit rate is intended to represent the actual rate that would be paid by a bank on an overnight deposit of euros.

Investor Fee: The investor fee is equal to 0.40% per year *times* the principal amount of your Securities *times* the index factor, calculated on a daily basis in the following manner: The investor fee on the inception date will equal zero. On each subsequent calendar day until maturity or early redemption, the investor fee will increase by an amount equal to (1) 0.40% *times* (2) the principal amount of your Securities *times* (3) the index factor on that day (or, if such day is not a trading day, the index factor on the immediately preceding trading day) *divided by* (4) 365. Because the net effect of the investor fee is a fixed percentage of the value of each Security, the aggregate effect of the investor fee will increase or decrease in a manner directly proportional to the value of each Security and the amount of Securities that are held, as applicable.

Because the investor fee reduces the amount of your return at maturity or upon redemption, the EUR/USD exchange rate may need to increase significantly in order for you to receive at least the principal amount of your investment at maturity or upon redemption. If the increase in the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) is insufficient to offset the negative effect of the investor fee, or the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) decreases, you will receive less than the principal amount of your investment at maturity or upon redemption.

Daycount Fraction: The daycount fraction on any business day will be the number of calendar days that have elapsed since the immediately preceding business day *divided by* 365.

Trading Day: A trading day is a day on which (i) the EUR/USD exchange rate is reported on Reuters page 1FED (or, after December 17, 2008, Bloomberg screen EURUSD WMCO Curncy <GO>) or any successor page, (ii) trading is generally conducted on NYSE Arca and (iii) trading is generally conducted in the interbank market, in each case as determined by the calculation agent in its sole discretion.

We sold a portion of the Securities on the inception date at 100% of their stated principal amount. The remainder of the Securities will be offered and sold from time to time through Barclays Capital Inc., our affiliate, as agent. Sales of the Securities after the inception date will be made at market prices prevailing at the time of sale, at prices related to market prices or at negotiated prices. Barclays Capital Inc. will not receive an agent's commission in connection with sales of the Securities. Please see "Supplemental Plan of Distribution" in this pricing supplement for more information.

We may use this pricing supplement in the initial sale of Securities. In addition, Barclays Capital Inc. or another of our affiliates may use this pricing supplement in market-making transactions in any Securities after their initial sale. ***Unless we or our agent informs you otherwise in the confirmation of sale or in a notice delivered at the same time as the confirmation of sale, this pricing supplement is being used in a market-making transaction.***

The Securities are not deposit liabilities of Barclays Bank PLC and are not insured by the United States Federal Deposit Insurance Corporation or any other governmental agency of the United States, the United Kingdom or any other jurisdiction.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined that this pricing supplement is truthful or complete. Any representation to the contrary is a criminal offense.

Patent pending

Pricing Supplement dated July 18, 2016
Issued in denominations of $50

TABLE OF CONTENTS

PRICING SUPPLEMENT

PROSPECTUS SUPPLEMENT

PROSPECTUS

PRICING SUPPLEMENT SUMMARY

The following is a summary of terms of the iPath® Exchange-Traded Notes due May 14, 2037 (the "Securities") and linked to the euro / U.S. dollar exchange rate (the "EUR/USD exchange rate" or the "Index") as well as a discussion of risks and other considerations you should take into account when deciding whether to invest in the Securities. The information in this section is qualified in its entirety by the more detailed explanations set forth elsewhere in this pricing supplement and the accompanying prospectus and prospectus supplement. References to the "prospectus" mean our accompanying prospectus, dated July 18, 2016, and references to the "prospectus supplement" mean our accompanying prospectus supplement, dated July 18, 2016, which supplements the prospectus.

We may, without your consent, create and issue additional securities having the same terms and conditions as the Securities. We may consolidate the additional securities to form a single class with the outstanding Securities. However, we are under no obligation to sell additional Securities at any time and if we do sell additional Securities, we may limit such sales and stop selling additional Securities at any time.

This section summarizes the following aspects of the Securities:

- What are the Securities and how do they work?
- How do you redeem your Securities?
- What are some of the risks of the Securities?
- Is this the right investment for you?
- What are the tax consequences?
- What is the euro?
- What does the EUR/USD exchange rate reflect?
- How do the Securities perform?

What Are the Securities and How Do They Work?

The Securities are medium-term notes that are uncollateralized debt securities and are linked to the performance of the EUR/USD exchange rate. The Securities will be issued in denominations of $50.

The EUR/USD exchange rate is a foreign exchange spot rate that measures the relative values of two currencies, the euro and the U.S. dollar. When the euro appreciates relative to the U.S. dollar, the EUR/USD exchange rate (and the value of the Securities) increases; when the euro depreciates relative to the U.S. dollar, the EUR/USD exchange rate (and the value of the Securities) decreases. The EUR/USD exchange rate is expressed as a rate that reflects the number of U.S. dollars that can be exchanged for one euro in the interbank market for settlement in two days. From and including the inception date to and including December 17, 2008, the EUR/USD exchange rate is the rate reported each day shortly after 10:00 a.m. on Reuters page 1FED. Due to the announcement by the Federal Reserve Bank of New York that it would discontinue the publication of foreign exchange rates on December 31, 2008, after December 17, 2008 the EUR/USD exchange rate is the rate reported each day on Bloomberg screen EURUSD WMCO Curncy <GO> at approximately 4 p.m., London time, or any successor page.

Understanding the Value of the Securities

The "**stated principal amount**" is $50.00 per Security, which is the initial offering price at which the Securities were sold on the inception date.

The "**daily redemption value**" is the value of the Securities calculated by us on a daily basis and is used to determine the payment at maturity or upon early redemption. The daily redemption value for each Security on the initial valuation date will equal $50. On each subsequent calendar day until maturity or early redemption, the daily redemption value for each Security will equal (1) the principal amount of the Securities *times* (2) the applicable index factor on the applicable valuation date *minus* (3) the investor fee on the applicable valuation date.

The "**intraday indicative value**" is intended to provide investors with an approximation of the effect that changes in the performance of the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) during the current trading day would have on the daily redemption value of the Securities from the previous day. Intraday indicative value differs from the daily redemption value in two important respects. First, intraday indicative value is based on the most recent published EUR/USD exchange rate and deposit rate, rather than the index factor for the immediately preceding calendar day. Second, the intraday indicative value only reflects the investor fee at the close of business on the preceding calendar day, but does not include any adjustment for the investor fee during the course of the current day.

If you sell your Securities on the secondary market, you will receive the "**trading price**" for your Securities, which may be substantially above or below the stated principal amount, daily redemption value and/or the intraday indicative value because the trading price reflects investor supply and demand for the Securities. In addition, if you purchase your Securities at a price which reflects a premium over the daily redemption value, you may experience a significant loss if you sell or redeem your Securities at a time when such premium is no longer present in the market place.

The intraday indicative value is calculated and published by NYSE Euronext (NYSE) or a successor under the ticker symbol ERO.IV.

The performance of the Securities is linked to the performance of the EUR/USD exchange rate *less* an investor fee. There is no minimum limit to the performance of the EUR/USD exchange rate. Moreover, the Securities are not principal protected. Therefore, a decrease in the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) could cause you to lose up to your entire investment in the Securities.

Furthermore, because the investor fee reduces the amount of your return at maturity or upon redemption, the value of the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) must increase significantly in order for you to receive at least the principal amount of your investment at maturity or upon redemption. If the value of the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) decreases or does not increase sufficiently, you will receive less than the principal amount of your investment at maturity or upon redemption.

How Do You Redeem Your Securities?

To redeem your Securities, you must instruct your broker or other person through whom you hold your Securities to take the following steps:

- deliver a notice of redemption, which is attached as Annex A, to us via facsimile or email by no later than 4:00 p.m., New York City time, on the business day prior to the applicable valuation date. If we receive your notice by the time specified in the preceding sentence, we will respond by sending you a form of confirmation of redemption, which is attached as Annex B;
- deliver the signed confirmation of redemption to us via facsimile or email in the specified form by 5:00 p.m., New York City time, on the same day. We or our affiliate must acknowledge receipt in order for your confirmation to be effective;
- instruct your DTC custodian to book a delivery vs. payment trade with respect to your Securities on the valuation date at a price per Security equal to the applicable daily redemption value, facing Barclays DTC 5101; and
- cause your DTC custodian to deliver the trade as booked for settlement via DTC at or prior to 10:00 a.m., New York City time, on the applicable redemption date (the third business day following the valuation date).

Different brokerage firms may have different deadlines for accepting instructions from their customers. Accordingly, you should consult the brokerage firm through which you own your interest in the Securities in respect of such deadlines. If we do not receive your notice of redemption by 4:00 p.m., New York City time, or your confirmation of redemption by 5:00 p.m., New York City time, on the business day prior to the applicable valuation date, your notice will not

be effective and we will not redeem your Securities on the applicable redemption date. Any redemption instructions for which we (or our affiliate) receive a valid confirmation in accordance with the procedures described above will be irrevocable.

What Are Some of the Risks of the Securities?

An investment in the Securities involves risks. Some of these risks are summarized here, but we urge you to read the more detailed explanation of risks in "Risk Factors" in this pricing supplement.

- **Uncertain Principal Repayment** – If the EUR/USD exchange rate decreases or does not increase sufficiently, after accounting for the accumulation component, to offset any negative effect of the investor fee, you may receive less than your original investment in the Securities.
- **Currency Risk** – The return on the Securities is linked to the performance of the EUR/USD exchange rate which, in turn, is linked to the values of the U.S. dollar and the euro. Currency prices may change unpredictably, affecting the EUR/USD exchange rate and, consequently, the value of your Securities in unforeseeable ways.
- **No Interest Payments** – You will not receive any periodic interest payments on the Securities.
- **A Trading Market for the Securities May Not Exist** – Although we have listed the Securities on NYSE Arca, a trading market for your Securities may not exist at any time. Certain affiliates of Barclays Bank PLC intend to engage in limited purchase and resale transactions. If they do, however, they are not required to do so and may stop at any time. We are not required to maintain any listing of the Securities on NYSE Arca or on any other exchange.

Is This the Right Investment for You?

The Securities may be a suitable investment for you if:

- You are willing to accept the risk of fluctuations in currency prices in general and the EUR/USD exchange rate in particular.
- You believe the value of the euro relative to the U.S. dollar and/or the accumulation component will increase by an amount sufficient to offset any negative effect of the investor fee during the term of the Securities.
- You do not seek current income from this investment.
- You seek an investment with a return linked to the performance of the EUR/USD exchange rate.
- You do not seek a guaranteed return of principal.

The Securities may not be a suitable investment for you if:

- You are not willing to be exposed to fluctuations in currency prices in general and the EUR/USD exchange rate in particular.
- You believe the value of the euro relative to the U.S. dollar will decrease or will not increase by an amount sufficient to offset any negative effect of the investor fee during the term of the Securities, even after accounting for the accumulation component.
- You prefer the lower risk and therefore accept the potentially lower returns of fixed income investments with comparable maturities and credit ratings.
- You seek current income from your investment.
- You seek a guaranteed return of principal.

What Are the Tax Consequences?

In the opinion of Sullivan & Cromwell LLP, pursuant to Revenue Ruling 2008-1, subject to certain assumptions set forth below under "Material U.S. Federal Income Tax Considerations", your Securities should be treated as debt instruments denominated in euro that are variable rate debt instruments subject to the original issue discount rules applicable to foreign currency-denominated notes. Under those rules, you must include original issue

discount, or OID, in your gross income for federal income tax purposes as it accrues (regardless of your method of accounting), even though you will not receive cash attributable to that income until the sale, early redemption or maturity of your Securities. In general, the effect of these rules is that you should be required to accrue an amount of OID with respect to your Securities for each taxable year that is equal to the accumulation component for that year minus the investor fee that accrued in such year.

For a more complete discussion of the U.S. federal income tax consequences of your investment in the Securities, see "Material U.S. Federal Income Tax Considerations" in this pricing supplement. You should consult your tax advisor as to the possible alternative treatments in respect of the Securities.

Conflicts of Interest

Barclays Capital Inc. is an affiliate of Barclays Bank PLC and, as such, has a "conflict of interest" in this offering within the meaning of FINRA Rule 5121 of the Financial Regulatory Industry Authority ("**FINRA**"). Consequently, this offering is being conducted in compliance with the provisions of Rule 5121 (or any successor rule thereto). For more information, please refer to "Plan of Distribution (Conflicts of Interest)—Conflict of Interest" in the accompanying prospectus supplement.

What is the Euro?

The euro is the official currency of the member states of the European Economic and Monetary Union (the "European Monetary Union"). It was introduced in January 1999 and replaced the national currencies of the then 11 participating countries. Today, the euro is the official currency of 16 nations including: Germany, Belgium, Greece, Luxembourg, Spain, France, Slovenia, Ireland, Italy, the Netherlands, Austria, Portugal, Finland, Cypress, Malta and Slovakia. Other current and future European Monetary Union countries may adopt the euro as their official currency. We have obtained all information in this pricing supplement relating to the European Monetary Union, the euro and the EUR/USD exchange rate from public sources, without independent verification.

What Does the EUR/USD Exchange Rate Reflect?

The EUR/USD exchange rate is a foreign exchange spot rate that measures the relative values of two currencies, the euro and the U.S. dollar. When the euro appreciates relative to the U.S. dollar, the EUR/USD exchange rate (and the value of the Securities) increases; when the euro depreciates relative to the U.S. dollar, the EUR/USD exchange rate (and the value of the Securities) decreases. The EUR/USD exchange rate is expressed as a rate that reflects the number of U.S. dollars that can be exchanged for one euro in the interbank market for settlement in two days. From and including the inception date to and including December 17, 2008, the EUR/USD exchange rate is the rate reported each day shortly after 10:00 a.m. on Reuters page 1FED. Due to the announcement by the Federal Reserve Bank of New York that it would discontinue the publication of foreign exchange rates on December 31, 2008, after December 17, 2008 the EUR/USD exchange rate is the rate reported each day on Bloomberg screen EURUSD WMCO Curncy <GO> at approximately 4 p.m., London time, or any successor page.

How Do the Securities Perform?

Set forth below is an explanation of the steps necessary to calculate the payment on the Securities at maturity or upon redemption.

Step 1: Calculate the currency component

The currency component on any given day will be equal to the EUR/USD exchange rate on that day (or, if such day is not a trading day, the EUR/USD exchange rate on the immediately preceding trading day) *divided by* the EUR/USD exchange rate on the inception date.

Step 2: Calculate the accumulation component

The accumulation component will be calculated on a daily basis in the following manner: The accumulation component on the inception date will equal one. On each subsequent business day until maturity or early redemption, the accumulation component will equal (1) the accumulation component on the immediately preceding business day *times* (2) the sum of one *plus* the product of the deposit rate *times* the relevant daycount fraction.

Step 3: Calculate the index factor

The index factor on any given day will be equal to the currency component on that day *times* the accumulation component on that day.

Step 4: Calculate the investor fee

The investor fee is equal to 0.40% per year *times* the principal amount of your Securities *times* the index factor, calculated on a daily basis in the following manner: The investor fee on the inception date will equal zero. On each subsequent calendar day until maturity or early redemption, the investor fee will increase by an amount equal to (1) 0.40% *times* (2) the principal amount of your Securities *times* (3) the index factor on that day (or, if such day is not a trading day, the index factor on the immediately preceding trading day) *divided by* (4) 365.

Step 5: Calculate the payment

You will receive a cash payment at maturity or upon redemption, as applicable, equal to (1) the principal amount of your Securities *times* (2) the index factor on the applicable valuation date *minus* (3) the investor fee on the applicable valuation date.

The performance of the Securities is linked to the performance of the EUR/USD exchange rate less an investor fee. There is no minimum limit to the performance of the EUR/USD exchange rate. Moreover, the Securities are not principal protected. Therefore, a decrease in the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) could cause you to lose up to your entire investment in the Securities.

Because the investor fee reduces the amount of your return at maturity or upon redemption, the EUR/USD exchange rate may need to increase significantly in order for you to receive at least the principal amount of your investment at maturity or upon redemption. If the increase in the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) is insufficient to offset the negative effect of the investor fee, or the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) decreases, you will receive less than the principal amount of your investment at maturity or upon redemption.

Hypothetical Examples

The following examples show how the Securities would perform in hypothetical circumstances. We have included two examples in which the EUR/USD exchange rate has decreased by approximately 50% at maturity, as well as two examples in which the EUR/USD exchange rate has increased by approximately 170% at maturity. These examples also highlight the behavior of the accumulation component in different circumstances. Because the accumulation component is a weighted average measure, the absolute level of the accumulation component will be dependent upon the path taken by the deposit rate during the term of the Securities. The figures in these examples have been rounded for convenience. Figures for year end 30 in each example are as of the final valuation date, and given the indicated assumptions, a holder will receive payment in the indicated amount, according to the indicated formula.

The hypothetical examples in this section do not take into account the effects of applicable taxes. The after-tax return you receive on your Securities will depend on the U.S. tax treatment of your Securities and on your particular circumstances. Accordingly, the after-tax rate of return of your Securities could be different than the after-tax return of a direct investment in the Index components or the Index.

Assumptions:

Yearly Fee	Days	Principal	Starting EUR/USD Exchange Rate	Starting Deposit Rate
0.40%	365	$50.00	1.356	3.81%

A Year	B EUR/USD Exchange Rate	C Currency Component	D Average Deposit Rate	E Average Accumulation Component	F Index Factor	G Yearly Fee	H Cumulative Investor Fee	I Average Indicative Value
A	*B*	*B/Starting Exchange Rate*	*D*	*Running Total of D*	*C x E*	*F x Principal x 0.40%*	*Running Total of G*	*(Principal x F) - H*
0	1.356	1.0000	0.000%	1.0000	100.00%	$0.00	$0.00	$50.00
1	1.425	1.0509	2.246%	1.0225	107.45%	$0.21	$0.21	$53.51
2	1.428	1.0535	2.464%	1.0477	110.37%	$0.22	$0.44	$54.75
3	1.449	1.0689	1.794%	1.0665	114.00%	$0.23	$0.66	$56.33
4	1.307	0.9643	1.470%	1.0821	104.34%	$0.21	$0.87	$51.30
5	1.353	0.9982	1.742%	1.1010	109.90%	$0.22	$1.09	$53.86
6	1.392	1.0269	1.124%	1.1134	114.33%	$0.23	$1.32	$55.85
7	1.287	0.9494	1.065%	1.1252	106.83%	$0.21	$1.53	$51.88
8	1.108	0.8173	0.740%	1.1335	92.64%	$0.19	$1.72	$44.60
9	1.206	0.8898	0.917%	1.1439	101.79%	$0.20	$1.92	$48.97
10	1.170	0.8632	1.271%	1.1585	100.00%	$0.20	$2.12	$47.88
11	1.200	0.8853	0.819%	1.1680	103.40%	$0.21	$2.33	$49.37
12	0.999	0.7368	1.093%	1.1807	86.99%	$0.17	$2.50	$40.99
13	0.979	0.7222	1.061%	1.1933	86.17%	$0.17	$2.68	$40.41
14	0.927	0.6841	1.298%	1.2088	82.69%	$0.17	$2.84	$38.50
15	0.860	0.6348	0.957%	1.2203	77.46%	$0.15	$3.00	$35.73
16	0.759	0.5599	0.884%	1.2311	68.93%	$0.14	$3.13	$31.33
17	0.895	0.6602	0.601%	1.2385	81.77%	$0.16	$3.30	$37.59
18	0.925	0.6822	0.608%	1.2460	85.01%	$0.17	$3.47	$39.04
19	0.945	0.6969	0.895%	1.2572	87.61%	$0.18	$3.64	$40.16
20	0.890	0.6569	0.624%	1.2650	83.09%	$0.17	$3.81	$37.74
21	0.996	0.7346	0.611%	1.2727	93.50%	$0.19	$4.00	$42.75
22	1.061	0.7824	0.525%	1.2794	100.11%	$0.20	$4.20	$45.86
23	0.947	0.6986	0.366%	1.2841	89.70%	$0.18	$4.38	$40.48
24	0.927	0.6836	0.707%	1.2932	88.40%	$0.18	$4.55	$39.65
25	0.949	0.6999	0.687%	1.3021	91.14%	$0.18	$4.74	$40.83
26	0.964	0.7111	0.579%	1.3096	93.13%	$0.19	$4.92	$41.64
27	0.887	0.6546	0.568%	1.3171	86.21%	$0.17	$5.09	$38.01
28	0.801	0.5910	0.976%	1.3299	78.60%	$0.16	$5.25	$34.05
29	0.811	0.5980	1.075%	1.3442	80.39%	$0.16	$5.41	$34.78
30	0.701	0.5170	1.986%	1.3709	70.87%	$0.14	$5.55	$29.88
							Annualized iPath® Indicative Value Return	**-1.70%**
							Total Return	**-40.24%**

Hypothetical Examples

A Year	B EUR/USD Exchange Rate	C Currency Component	D Average Deposit Rate	E Average Accumulation Component	F Index Factor	G Yearly Fee	H Cumulative Investor Fee	I Average Indicative Value
A	*B*	*B/Starting Exchange Rate*	*D*	*Running Total of D*	*C x E*	*F x Principal x 0.40%*	*Running Total of G*	*(Principal x F) - H*
0	1.356	1.0000	0.000%	1.0000	100.00%	$0.00	$0.00	$50.00
1	1.425	1.0509	4.108%	1.0411	109.41%	$0.22	$0.22	$54.49
2	1.428	1.0535	5.356%	1.0968	115.55%	$0.23	$0.45	$57.33
3	1.449	1.0689	7.168%	1.1755	125.65%	$0.25	$0.70	$62.12
4	1.307	0.9643	5.956%	1.2455	120.10%	$0.24	$0.94	$59.11
5	1.353	0.9982	5.959%	1.3197	131.73%	$0.26	$1.20	$64.66
6	1.392	1.0269	5.832%	1.3967	143.43%	$0.29	$1.49	$70.22
7	1.287	0.9494	6.745%	1.4909	141.55%	$0.28	$1.77	$69.00
8	1.108	0.8173	7.604%	1.6042	131.11%	$0.26	$2.04	$63.52
9	1.206	0.8898	6.664%	1.7111	152.26%	$0.30	$2.34	$73.79
10	1.170	0.8632	6.540%	1.8230	157.37%	$0.31	$2.66	$76.03
11	1.200	0.8853	6.520%	1.9419	171.92%	$0.34	$3.00	$82.96
12	0.999	0.7368	6.896%	2.0758	152.94%	$0.31	$3.31	$73.16
13	0.979	0.7222	8.357%	2.2493	162.43%	$0.32	$3.63	$77.59
14	0.927	0.6841	8.159%	2.4328	166.42%	$0.33	$3.96	$79.25
15	0.860	0.6348	7.477%	2.6147	165.97%	$0.33	$4.30	$78.69
16	0.759	0.5599	8.508%	2.8372	158.86%	$0.32	$4.61	$74.82
17	0.895	0.6602	10.442%	3.1334	206.88%	$0.41	$5.03	$98.41
18	0.925	0.6822	7.989%	3.3838	230.85%	$0.46	$5.49	$109.94
19	0.945	0.6969	9.145%	3.6932	257.38%	$0.51	$6.00	$122.69
20	0.890	0.6569	11.138%	4.1045	269.61%	$0.54	$6.54	$128.26
21	0.996	0.7346	9.083%	4.4773	328.91%	$0.66	$7.20	$157.25
22	1.061	0.7824	6.386%	4.7632	372.69%	$0.75	$7.95	$178.40
23	0.947	0.6986	7.334%	5.1126	357.15%	$0.71	$8.66	$169.91
24	0.927	0.6836	6.917%	5.4662	373.65%	$0.75	$9.41	$177.42
25	0.949	0.6999	7.556%	5.8793	411.50%	$0.82	$10.23	$195.52
26	0.964	0.7111	6.691%	6.2727	446.06%	$0.89	$11.12	$211.91
27	0.887	0.6546	5.991%	6.6484	435.17%	$0.87	$11.99	$205.59
28	0.801	0.5910	7.215%	7.1281	421.26%	$0.84	$12.84	$197.79
29	0.811	0.5980	6.099%	7.5629	452.29%	$0.90	$13.74	$212.41
30	0.701	0.5170	8.370%	8.1959	423.70%	$0.85	$14.59	$197.26
							Annualized iPath® Indicative Value Return	**4.68%**
							Total Return	**294.52%**

Hypothetical Examples

A Year	B EUR/USD Exchange Rate	C Currency Component	D Average Deposit Rate	E Average Accumulation Component	F Index Factor	G Yearly Fee	H Cumulative Investor Fee	I Average Indicative Value
A	*B*	*B/Starting Exchange Rate*	*D*	*Running Total of D*	*C x E*	*F x Principal x 0.40%*	*Running Total of G*	*(Principal x F) - H*
0	1.356	1.0000	0.000%	1.0000	100.00%	$0.00	$0.00	$50.00
1	1.284	0.9472	2.246%	1.0225	96.85%	$0.19	$0.19	$48.23
2	1.311	0.9672	2.464%	1.0477	101.33%	$0.20	$0.40	$50.27
3	1.423	1.0494	1.794%	1.0665	111.92%	$0.22	$0.62	$55.34
4	1.395	1.0293	1.470%	1.0821	111.39%	$0.22	$0.84	$54.85
5	1.538	1.1346	1.742%	1.1010	124.92%	$0.25	$1.09	$61.36
6	1.811	1.3363	1.124%	1.1134	148.77%	$0.30	$1.39	$73.00
7	1.896	1.3983	1.065%	1.1252	157.34%	$0.31	$1.71	$76.96
8	1.822	1.3443	0.740%	1.1335	152.38%	$0.30	$2.01	$74.18
9	1.942	1.4329	0.917%	1.1439	163.92%	$0.33	$2.34	$79.62
10	2.169	1.6004	1.271%	1.1585	185.40%	$0.37	$2.71	$89.99
11	1.916	1.4133	0.819%	1.1680	165.06%	$0.33	$3.04	$79.49
12	2.111	1.5572	1.093%	1.1807	183.86%	$0.37	$3.41	$88.52
13	1.831	1.3503	1.061%	1.1933	161.13%	$0.32	$3.73	$76.84
14	1.741	1.2840	1.298%	1.2088	155.20%	$0.31	$4.04	$73.56
15	1.965	1.4493	0.957%	1.2203	176.86%	$0.35	$4.39	$84.04
16	2.427	1.7906	0.884%	1.2311	220.44%	$0.44	$4.83	$105.38
17	2.435	1.7964	0.601%	1.2385	222.48%	$0.44	$5.28	$105.96
18	2.434	1.7957	0.608%	1.2460	223.74%	$0.45	$5.73	$106.15
19	2.400	1.7702	0.895%	1.2572	222.54%	$0.45	$6.17	$105.10
20	2.495	1.8405	0.624%	1.2650	232.82%	$0.47	$6.64	$109.77
21	2.465	1.8183	0.611%	1.2727	231.42%	$0.46	$7.10	$108.61
22	2.638	1.9462	0.525%	1.2794	249.00%	$0.50	$7.60	$116.90
23	2.849	2.1017	0.366%	1.2841	269.88%	$0.54	$8.14	$126.80
24	2.832	2.0893	0.707%	1.2932	270.19%	$0.54	$8.68	$126.41
25	3.213	2.3703	0.687%	1.3021	308.63%	$0.62	$9.29	$145.02
26	3.471	2.5605	0.579%	1.3096	335.33%	$0.67	$9.97	$157.70
27	3.446	2.5424	0.568%	1.3171	334.85%	$0.67	$10.64	$156.79
28	3.320	2.4489	0.976%	1.3299	325.68%	$0.65	$11.29	$151.55
29	4.070	3.0024	1.075%	1.3442	403.59%	$0.81	$12.09	$189.70
30	3.679	2.7139	1.986%	1.3709	372.06%	$0.74	$12.84	$173.19
							Annualized iPath® Indicative Value Return	**4.23%**
							Total Return	**246.38%**

Hypothetical Examples

A Year	B EUR/USD Exchange Rate	C Currency Component	D Average Deposit Rate	E Average Accumulation Component	F Index Factor	G Yearly Fee	H Cumulative Investor Fee	I Average Indicative Value
A	*B*	*B/Starting Exchange Rate*	*D*	*Running Total of D*	*C x E*	*F x Principal x 0.40%*	*Running Total of G*	*(Principal x F) - H*
0	1.356	1.0000	0.000%	1.0000	100.00%	$0.00	$0.00	$50.00
1	1.284	0.9472	4.108%	1.0411	98.62%	$0.20	$0.20	$49.11
2	1.311	0.9672	5.356%	1.0968	106.08%	$0.21	$0.41	$52.63
3	1.423	1.0494	7.168%	1.1755	123.36%	$0.25	$0.66	$61.02
4	1.395	1.0293	5.956%	1.2455	128.20%	$0.26	$0.91	$63.19
5	1.538	1.1346	5.959%	1.3197	149.73%	$0.30	$1.21	$73.65
6	1.811	1.3363	5.832%	1.3967	186.63%	$0.37	$1.59	$91.73
7	1.896	1.3983	6.745%	1.4909	208.47%	$0.42	$2.00	$102.23
8	1.822	1.3443	7.604%	1.6042	215.66%	$0.43	$2.43	$105.39
9	1.942	1.4329	6.664%	1.7111	245.19%	$0.49	$2.92	$119.67
10	2.169	1.6004	6.540%	1.8230	291.76%	$0.58	$3.51	$142.37
11	1.916	1.4133	6.520%	1.9419	274.45%	$0.55	$4.06	$133.17
12	2.111	1.5572	6.896%	2.0758	323.24%	$0.65	$4.70	$156.92
13	1.831	1.3503	8.357%	2.2493	303.73%	$0.61	$5.31	$146.56
14	1.741	1.2840	8.159%	2.4328	312.37%	$0.62	$5.93	$150.25
15	1.965	1.4493	7.477%	2.6147	378.96%	$0.76	$6.69	$182.79
16	2.427	1.7906	8.508%	2.8372	508.01%	$1.02	$7.71	$246.30
17	2.435	1.7964	10.442%	3.1334	562.89%	$1.13	$8.83	$272.61
18	2.434	1.7957	7.989%	3.3838	607.61%	$1.22	$10.05	$293.75
19	2.400	1.7702	9.145%	3.6932	653.75%	$1.31	$11.36	$315.52
20	2.495	1.8405	11.138%	4.1045	755.42%	$1.51	$12.87	$364.84
21	2.465	1.8183	9.083%	4.4773	814.10%	$1.63	$14.50	$392.55
22	2.638	1.9462	6.386%	4.7632	927.01%	$1.85	$16.35	$447.15
23	2.849	2.1017	7.334%	5.1126	1074.50%	$2.15	$18.50	$518.75
24	2.832	2.0893	6.917%	5.4662	1142.06%	$2.28	$20.78	$550.25
25	3.213	2.3703	7.556%	5.8793	1393.54%	$2.79	$23.57	$673.20
26	3.471	2.5605	6.691%	6.2727	1606.13%	$3.21	$26.78	$776.28
27	3.446	2.5424	5.991%	6.6484	1690.30%	$3.38	$30.16	$814.99
28	3.320	2.4489	7.215%	7.1281	1745.59%	$3.49	$33.65	$839.14
29	4.070	3.0024	6.099%	7.5629	2270.69%	$4.54	$38.20	$1,097.15
30	3.679	2.7139	8.370%	8.1959	2224.30%	$4.45	$42.64	$1,069.51
							Annualized iPath® Indicative Value Return	**10.75%**
							Total Return	**2039.01%**

RISK FACTORS

The Securities are unsecured promises of Barclays Bank PLC and are not secured debt. The Securities are riskier than ordinary unsecured debt securities. The return on the Securities is linked to the performance of the EUR/USD exchange rate. Investing in the Securities is not equivalent to investing directly in the U.S. dollar, the euro or other securities or future contracts linked to the EUR/USD exchange rate. See "The Index" below for more information.

This section describes the most significant risks relating to an investment in the Securities. **We urge you to read the following information about these risks, together with the other information in this pricing supplement and the accompanying prospectus and prospectus supplement, before investing in the Securities.**

You should also consider the tax consequences of investing in the Securities, significant aspects of which are uncertain. See "Material U.S. Federal Income Tax Considerations" in this pricing supplement.

Even If the Value of the EUR/USD Exchange Rate at Maturity or Upon Redemption Is Greater than It Was on the Inception Date, You May Receive Less than the Principal Amount of Your Securities

The performance of the Securities is linked to the performance of the EUR/USD exchange rate less an investor fee. There is no minimum limit to the performance of the EUR/USD exchange rate. Moreover, the Securities are not principal protected. Therefore, a decrease in the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) could cause you to lose up to your entire investment.

Furthermore, because the investor fee reduces the amount of your return at maturity or upon redemption, the EUR/USD exchange rate may need to increase significantly in order for you to receive at least the principal amount of your investment at maturity or upon redemption. If the increase in the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) is insufficient to offset the negative effect of the investor fee, or the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) decreases, you will receive less than the principal amount of your investment at maturity or upon redemption.

You Will Not Benefit from any Increase in the EUR/USD Exchange Rate if Such Increase Is Not Reflected in the EUR/USD Exchange Rate on the Applicable Valuation Date

If the positive effect of any increase in the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) is insufficient to offset the negative effect of the investor fee between the inception date and the applicable valuation date (including the final valuation date), we will pay you less than the principal amount of your Securities at maturity or upon redemption. This will be true even if the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) as of some date or dates prior to the applicable valuation date would have been sufficiently high to offset the negative effect of the investor fee.

There Are Restrictions on the Minimum Number of Securities You May Redeem and on the Dates on Which You May Redeem Them

You must redeem at least 50,000 Securities at one time in order to exercise your right to redeem your Securities on any redemption date. You may only redeem your Securities on a redemption date if we receive a notice of redemption from you by no later than 4:00 p.m., New York City time, and a confirmation of redemption by no later than 5:00 p.m., New York City time, on the business day prior to the applicable valuation date. If we do not receive your notice of redemption by 4:00 p.m., New York City time, or your confirmation of redemption by 5:00 p.m., New York City time, on the business day prior to the applicable valuation date, your notice will not be effective and we will not redeem your Securities on the applicable redemption date. Your notice of redemption and confirmation of redemption will not be effective until we confirm receipt. See "Specific Terms of the Securities – Redemption Procedures" for more information.

The Market Value of the Securities May Be Influenced by Many Unpredictable Factors

The market value of your Securities may fluctuate between the date you purchase them and the applicable valuation date. You may also sustain a significant loss if you sell the Securities in the secondary market. Several factors, many of which are beyond our control, will influence the market value of the Securities. We expect that generally changes in the EUR/USD exchange rate will affect the market value of the Securities more than any other factor. Other factors that may influence the market value of the Securities include:

- the time remaining to the maturity of the Securities;
- supply and demand for the Securities, including inventory positions with Barclays Capital Inc. or any market maker and any decision we may make not to issue additional Securities or to cease or suspend sales of Securities from inventory;
- interest rates, especially the EONIA;
- the volatility of the EUR/USD exchange rate;
- economic, financial, political, regulatory, geographical or judicial events that affect the EUR/USD exchange rate; or
- the creditworthiness of Barclays Bank PLC.

These factors interrelate in complex ways, and the effect of one factor on the market value of your Securities may offset or enhance the effect of another factor.

The EUR/USD Exchange Rate Will be Influenced by Unpredictable Factors

The EUR/USD exchange rate is a result of the supply of, and demand for, each currency. Changes in the EUR/USD exchange rate may result from the interactions of many factors including economic, financial, social and political conditions in Europe and the United States. These conditions include, for example, the overall growth and performance of the economies of the United States and the European Monetary Union, and the constituent nations thereof, the trade and current account balance between the United States and the nations of the European Monetary Union, inflation, interest rate levels, the performance of stock markets in the United States and Europe, the stability of the United States and European governments and banking systems, wars in which the United States or European nations are directly or indirectly involved or that occur anywhere in the world, major natural disasters in the United States or Europe, and other foreseeable and unforeseeable events.

Certain relevant information relating to the European Monetary Union and the constituent nations thereof may not be as well known or as rapidly or thoroughly reported in the United States as compared to U.S. developments. Prospective purchasers of the Securities should be aware of the possible lack of availability of important information that can affect the value of the euro in relation to the U.S. dollar and must be prepared to make special efforts to obtain such information on a timely basis.

The Liquidity, Trading Value and Amounts Payable Under the Securities Could be Affected by the Actions of Sovereign Governments, including the U.S. and European Governments, or of the European Monetary Union

Exchange rates of most developed economies, including the United States and the European Monetary Union, are "floating," meaning that they are permitted to fluctuate in value relative to other currencies. However, governments of other nations, from time to time, do not allow their currencies to float freely in response to economic forces. Governments, including the U.S. and European governments and the European Monetary Union authorities, use a variety of techniques, such as intervention by their central bank or imposition of regulatory controls or taxes, to affect the exchange rates of their respective currencies. Governments may also issue a new currency to replace an existing currency or alter the exchange rate or relative exchange characteristics by devaluation or revaluation of a currency. Thus, a special risk in purchasing the Securities is that their liquidity, trading value and amounts payable could be affected by the actions of the U.S. or European governments or of the European Monetary Union authorities which could change or interfere with theretofore freely determined

currency valuation, fluctuations in response to other market forces and the movement of currencies across borders. There will be no adjustment or change in the terms of the Securities in the event that exchange rates should become fixed, or in the event of any devaluation or revaluation or imposition of exchange or other regulatory controls or taxes, or in the event of the issuance of a replacement currency or in the event of other developments affecting the euro, the U.S. dollar or any other currency.

Even Though the U.S. Dollar and the Euro Are Traded Around-the-Clock, the Securities Will Trade Only During Regular Trading Hours in the United States

The interbank market for the U.S. dollar and the euro is a global, around-the-clock market. We have listed the Securities on NYSE Arca and the Securities trade only during the hours that NYSE Arca is open. To the extent that NYSE Arca is closed while the markets for the U.S. dollar and the euro remain open, significant price and rate movements may take place in the underlying foreign exchange markets that will not be reflected immediately in the price of the Securities.

Foreign Exchange Rate Information May Not Be Readily Available

There is no systematic reporting of last-sale information for foreign currencies. Reasonable current bid and offer information is available in certain brokers' offices, in bank foreign currency trading offices, and to others who wish to subscribe for this information, but this information will not necessarily reflect the EUR/USD exchange rate relevant for determining the value of the Securities. The absence of last-sale information and the limited availability of quotations to individual investors may make it difficult for many investors to obtain timely, accurate data about the state of the underlying foreign exchange markets.

Historical Levels of the EUR/USD Exchange Rate Should Not Be Taken as an Indication of the Future Performance of the EUR/USD Exchange Rate During the Term of the Securities

It is impossible to predict whether the EUR/USD exchange rate will rise or fall. The actual performance of the EUR/USD exchange rate over the term of the Securities, as well as the amount payable at maturity or upon redemption, may bear little relation to the historical level of the EUR/USD exchange rate.

Changes in the EONIA May Affect the Value of Your Securities

Because the value of the Securities is linked, in part, to the EONIA, changes in that rate will affect the amount payable on your Securities at maturity or upon redemption and, therefore, the market value of your Securities. Assuming the level of the EUR/USD exchange rate remains constant, an increase in the EONIA will increase the value of your Securities, while a decrease in the rate will decrease the value of your Securities.

Changes in Our Credit Ratings May Affect the Market Value of Your Securities

Our credit ratings are an assessment of our ability to pay our obligations, including those on the Securities. Consequently, actual or anticipated changes in our credit ratings may affect the market value of your Securities. However, because the return on your Securities is dependent upon certain factors in addition to our ability to pay our obligations on your Securities, an improvement in our credit ratings will not reduce the other investment risks related to your Securities.

Owning the Securities Is Not the Same as Owning Euros

The return on your Securities will not reflect the return you would realize if you actually purchased euros and converted them into U.S. dollars on the applicable valuation date. The EUR/USD exchange rate is calculated by reference to the euro relative to the U.S. dollar without taking into consideration the value of the euro relative to other currencies or in other markets.

You Will Not Receive Interest Payments on the Securities or Have the Right to Receive Euros

You will not receive any periodic interest payments on the Securities. Your Securities will be paid in U.S. dollars, and you will have no right to receive delivery of euros.

There May Not Be an Active Trading Market in the Securities; Sales in the Secondary Market May Result in Significant Losses

Although we have listed the Securities on NYSE Arca, there can be no assurance that a secondary market for the Securities will exist at any time. Even if there is a secondary market for the Securities, whether as a result of any listing of the Securities or on an over-the-counter basis, it may not provide enough liquidity for you to trade or sell your Securities easily.

Certain affiliates of Barclays Bank PLC may engage in limited purchase and resale transactions in the Securities, although they are not required to do so. If they decide to engage in such transactions, they may stop at any time.

We are not required to maintain any listing of the Securities on NYSE Arca or on any other securities exchange.

Trading and Other Transactions by Barclays Bank PLC or Its Affiliates in Instruments Linked to the U.S. Dollar, the Euro or the EUR/USD Exchange Rate May Impair the Market Value of the Securities

As described below under "Use of Proceeds and Hedging" in this pricing supplement, we or one or more of our affiliates may hedge our obligations under the Securities by purchasing U.S. dollars or euros, futures or options on U.S. dollars or euros or the EUR/USD exchange rate, or other derivative instruments with returns linked to the performance of the U.S. dollar or the euro or the EUR/USD exchange rate, and we may adjust these hedges by, among other things, purchasing or selling any of the foregoing. Although they are not expected to, any of these hedging activities may adversely affect the market price of the U.S. dollar or the euro and the EUR/USD exchange rate and, therefore, the market value of the Securities. It is possible that we or one or more of our affiliates could receive substantial returns from these hedging activities while the market value of the Securities declines.

We or one or more of our affiliates may also engage in trading in U.S. dollars or euros, futures or options on U.S dollars or euros, and other investments relating to the U.S. dollar or the euro or the EUR/USD exchange rate on a regular basis as part of our general broker-dealer and other businesses, for proprietary accounts, for other accounts under management or to facilitate transactions for customers. Any of these activities could adversely affect the market price of the U.S. dollar or the euro or the level of the EUR/USD exchange rate and, therefore, the market value of the Securities. We or one or more of our affiliates may also issue or underwrite other securities or financial or derivative instruments with returns linked or related to changes in the performance of any of the foregoing. By introducing competing products into the marketplace in this manner, we or one or more of our affiliates could adversely affect the market value of the Securities. With respect to any of the activities described above, neither Barclays Bank PLC nor its affiliates has any obligation to take the needs of any buyer, seller or holder of the Securities into consideration at any time.

The Liquidity of the Market for the Securities May Vary Materially Over Time

As stated on the cover of this pricing supplement, we sold a portion of the Securities on the inception date, and the remainder of the Securities will be offered and sold from time to time through Barclays Capital Inc., our affiliate, as agent. Also, the number of Securities outstanding or held by persons other than our affiliates could be reduced at any time due to early redemptions of the Securities. Accordingly, the liquidity of the market for the Securities could vary materially over the term of the Securities. While you may elect to redeem your Securities prior to maturity, early redemption is subject to the conditions and procedures described elsewhere in this pricing supplement, including the condition that you must redeem at least 50,000 Securities at one time in order to exercise your right to redeem your Securities on any redemption date.

The Securities May Trade at a Substantial Premium to or Discount from the Daily Redemption Value and/or Intraday Indicative Value

The Securities may trade at a substantial premium to or discount from the daily redemption value and/or the intraday indicative value. The daily redemption value is the value of the Securities calculated by us on a daily basis and is used to determine the payment at maturity or upon early redemption. The intraday indicative value is meant to approximate on an intraday basis the component of the Security's value that is attributable to the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) and is provided for reference purposes only. If you sell your Securities on the secondary market, you will receive the market price for your Securities, which may be substantially above or below the daily redemption value and/or intraday indicative value. In addition, if you purchase your Securities at a price which reflects a premium over the daily redemption value, you may experience a significant loss if you sell or redeem your Securities at a time when such premium is no longer present in the market place.

We Have No Obligation to Issue Additional Securities, and We May Cease or Suspend Sales of the Securities

As further described in the accompanying prospectus supplement under "Summary—Medium-Term Notes—Amounts That We May Issue" on page S-4 and "Summary—Medium-Term Notes—Reissuances or Reopened Issues" on page S-4, we have the right, but not the obligation, to issue additional Securities once the initial distribution is complete. We also reserve the right to cease or suspend sales of the Securities from inventory held by our affiliate Barclays Capital Inc. at any time after the inception date. If we choose not to issue additional Securities or to cease or suspend sales of the Securities from inventory, this will impact supply and demand for the Securities and may impact the liquidity and price of the Securities in the secondary market. As a result, if you buy or sell your Securities on the secondary market, the price that you pay or receive may be higher or lower than if we had decided to issue additional Securities or not to cease or suspend sales of the Securities from inventory at that time.

Our Business Activities May Create Conflicts of Interest

We and our affiliates expect to play a variety of roles in connection with the issuance of the Securities. As noted above, we and our affiliates expect to engage in trading activities related to U.S. dollars or euros , futures or options on U.S. dollars or euros or the EUR/USD exchange rate, or other derivative instruments with returns linked to the performance of the U.S. dollar or the euro or the EUR/USD exchange rate that are not for the account of holders of the Securities or on their behalf. These trading activities may present a conflict between the holders' interest in the Securities and the interests that we and our affiliates will have in our and our affiliates' proprietary accounts, in facilitating transactions, including options and other derivatives transactions, for our and our affiliates' customers and in accounts under our and our affiliates' management. These trading activities, if they influence the EUR/USD exchange rate, could be adverse to the interests of the holders of the Securities. Moreover, we and our affiliates have published and in the future expect to publish research reports with respect to the EUR/USD exchange rate and currencies generally. This research is modified from time to time without notice and may express opinions or provide recommendations that are inconsistent with purchasing or holding the Securities. The research should not be viewed as a recommendation or endorsement of the Securities in any way and investors must make their own independent investigation of the merits of this investment. Any of these activities by us, Barclays Capital Inc. or our other affiliates may affect the market price of the U.S. dollar or the euro and the EUR/USD exchange rate and, therefore, the market value of the Securities. With respect to any of the activities described above, neither Barclays Bank PLC nor its affiliates has any obligation to take the needs of any buyer, seller or holder of the Securities into consideration at any time.

There Are Potential Conflicts of Interest Between You and the Calculation Agent

Currently, Barclays Bank PLC serves as the calculation agent. We will, among other things, decide the amount of the return paid out to you on the Securities at maturity or upon redemption. For a more detailed description of the calculation agent's role, see "Specific Terms of the Securities – Role of Calculation Agent" in this pricing supplement.

Postponement of a Valuation Date May Result in a Reduced Amount Payable at Maturity or Upon Redemption

As the payment at maturity or upon redemption is a function of, among other things, the applicable index factor on the final valuation date or applicable valuation date, as the case may be, the postponement of any valuation date may result in the application of a different applicable index factor and, accordingly, decrease the payment you receive at maturity or upon redemption.

THE INDEX

We have obtained all information about the EUR/USD exchange rate from public sources, without independent verification.

The EUR/USD exchange rate is a foreign exchange spot rate that measures the relative values of two currencies, the euro and the U.S. dollar. When the euro appreciates relative to the U.S. dollar, the EUR/USD exchange rate (and the value of the Securities) increases; when the euro depreciates relative to the U.S. dollar, the EUR/USD exchange rate (and the value of the Securities) decreases. The EUR/USD exchange rate is expressed as a rate that reflects the number of U.S. dollars that can be exchanged for one euro in the interbank market for settlement in two days. From and including the inception date to and including December 17, 2008, the EUR/USD exchange rate is the rate reported each day shortly after 10:00 a.m. on Reuters page 1FED. Due to the announcement by the Federal Reserve Bank of New York that it would discontinue the publication of foreign exchange rates on December 31, 2008, after December 17, 2008 the EUR/USD exchange rate is the rate reported each day on Bloomberg screen EURUSD WMCO Curncy <GO> at approximately 4 p.m., London time, or any successor page.

U.S. dollars and euros are traded by all major foreign exchange traders around the world. The following table presents the level of the EUR/USD exchange rate at the end of each month since January 2000. We obtained the information set forth below on the level of the EUR/USD exchange rate through December 17, 2008 from the Federal Reserve Bank of New York without independent verification. For all dates following December 17, 2008 we obtained the information set forth below from Bloomberg screen EURUSD WMCO Curncy <GO>, without independent verification. You should not take the historical EUR/USD exchange rate as an indication of future performance.

January 31, 2000	0.9796
February 29, 2000	0.9674
March 31, 2000	0.9576
April 28, 2000	0.9098
May 31, 2000	0.9329
June 30, 2000	0.9585
July 31, 2000	0.9267
August 31, 2000	0.8898
September 29, 2000	0.8792
October 31, 2000	0.8476
November 30, 2000	0.8693
December 29, 2000	0.9307
January 31, 2001	0.9321
February 28, 2001	0.9207
March 30, 2001	0.8851
April 30, 2001	0.8871
May 31, 2001	0.8473
June 29, 2001	0.8473
July 31, 2001	0.8756
August 31, 2001	0.9152
September 28, 2001	0.9134
October 31, 2001	0.9014
November 30, 2001	0.8951
December 31, 2001	0.8911
January 31, 2002	0.8616
February 28, 2002	0.8635
March 29, 2002	0.8721
April 30, 2002	0.9024
May 31, 2002	0.9364
June 28, 2002	0.9925
July 31, 2002	0.9777
August 30, 2002	0.985

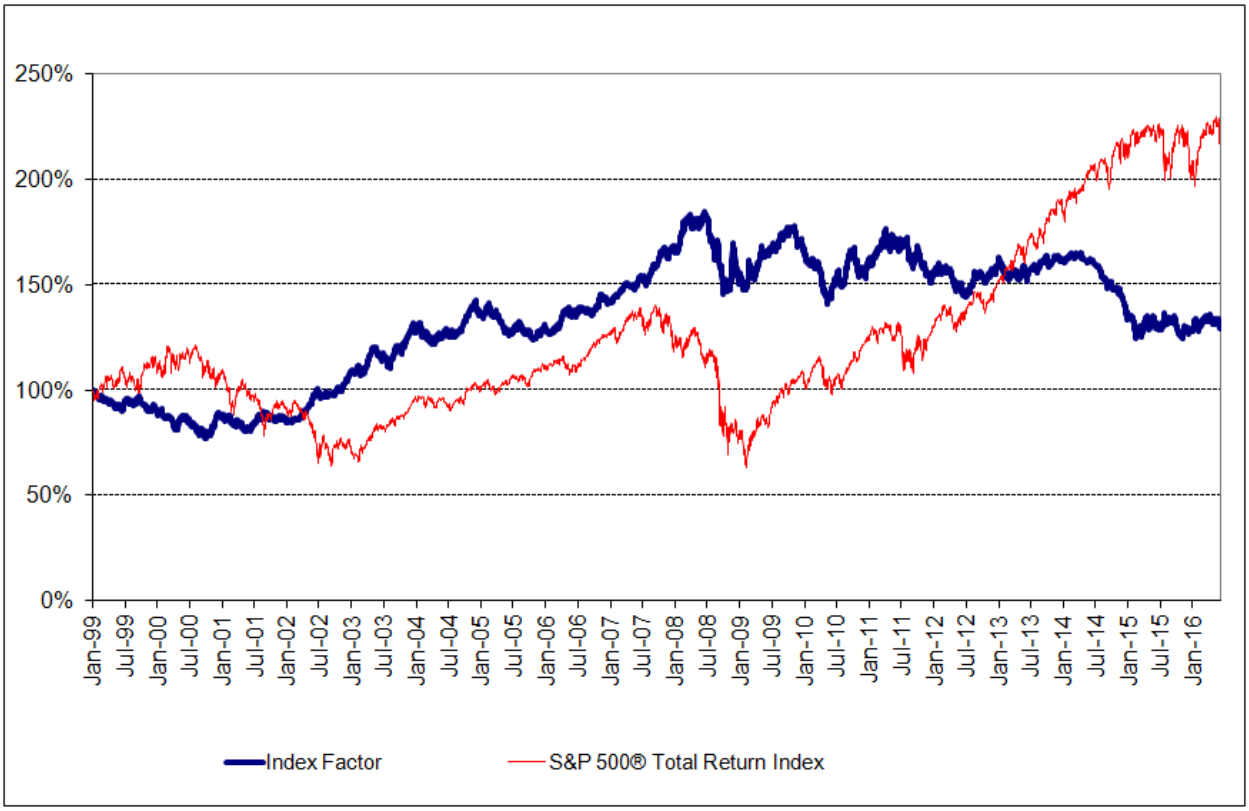
September 30, 2002	0.988
October 31, 2002	0.9893
November 29, 2002	0.9944
December 31, 2002	1.0476
January 31, 2003	1.0758
February 28, 2003	1.0791
March 31, 2003	1.0912
April 30, 2003	1.1142
May 30, 2003	1.1803
June 30, 2003	1.1454
July 31, 2003	1.1271
August 29, 2003	1.0956
September 30, 2003	1.1707
October 31, 2003	1.1618
November 28, 2003	1.2009
December 31, 2003	1.2623
January 30, 2004	1.2408
February 27, 2004	1.2477
March 31, 2004	1.229
April 30, 2004	1.1989
May 31, 2004	1.2252
June 30, 2004	1.2171
July 30, 2004	1.2094
August 31, 2004	1.2117
September 30, 2004	1.2401
October 29, 2004	1.274
November 30, 2004	1.331
December 31, 2004	1.3626
January 31, 2005	1.3036
February 28, 2005	1.3248
March 31, 2005	1.3004
April 29, 2005	1.2936
May 31, 2005	1.2351
June 30, 2005	1.2082
July 29, 2005	1.2132
August 31, 2005	1.2228
September 30, 2005	1.2031
October 31, 2005	1.2005
November 30, 2005	1.1768
December 30, 2005	1.1801
January 31, 2006	1.2124
February 28, 2006	1.1886
March 31, 2006	1.2102
April 28, 2006	1.2569
May 31, 2006	1.2854
June 30, 2006	1.2768
July 31, 2006	1.2764
August 31, 2006	1.2838
September 29, 2006	1.2658
October 31, 2006	1.272
November 30, 2006	1.3212
December 29, 2006	1.3184
January 31, 2007	1.2963
February 28, 2007	1.321
March 30, 2007	1.3309
April 30, 2007	1.364
May 31, 2007	1.345
June 29, 2007	1.3518
July 31, 2007	1.3706
August 31, 2007	1.3664
September 28, 2007	1.42
October 31, 2007	1.4447
November 30, 2007	1.4763
December 31, 2007	1.4682
January 31, 2008	1.4846
February 29, 2008	1.5185
March 31, 2008	1.5813
April 30, 2008	1.556
May 30, 2008	1.5511
June 30, 2008	1.578
July 31, 2008	1.5646
August 29, 2008	1.4706
September 30, 2008	1.4179
October 31, 2008	1.272
November 30, 2008	1.2719
December 31, 2008	1.3901
January 30, 2009	1.2815
February 27, 2009	1.2701
March 31, 2009	1.3277
April 30, 2009	1.3251
May 29, 2009	1.4154
June 30, 2009	1.4026
July 31, 2009	1.4178
August 31, 2009	1.4351
September 30, 2009	1.4617
October 30, 2009	1.4755
November 30, 2009	1.5013
December 31, 2009	1.4348
January 29, 2010	1.3900
February 26, 2010	1.3647
March 31, 2010	1.3531
April 30, 2010	1.3297
May 31, 2010	1.2271
June 30, 2010	1.2249
July 30, 2010	1.3028
August 31, 2010	1.2710

September 30, 2010	1.3652
October 29, 2010	1.3899
November 30, 2010	1.3018
December 31, 2010	1.3416
January 31, 2011	1.3710
February 28, 2011	1.3812
March 31, 2011	1.4191
April 29, 2011	1.4836
May 31, 2011	1.4376
June 30, 2011	1.4499
July 29, 2011	1.4370
August 31, 2011	1.4398
September 30, 2011	1.3417
October 31, 2011	1.3948
November 30, 2011	1.3462
December 30, 2011	1.2982
January 30, 2012	1.3114
February 29, 2012	1.3377
March 30, 2012	1.3317
April 30, 2012	1.3236
May 31, 2012	1.2365
June 29, 2012	1.2691
July 31, 2012	1.2316
August 31, 2012	1.2605
September 28, 2012	1.2865
October 31, 2012	1.2958
November 30, 2012	1.3006
December 31, 2012	1.3184
January 31, 2013	1.3574
February 28, 2013	1.3074
March 28, 2013	1.2841
April 30, 2013	1.3184
May 31, 2013	1.2960
June 28, 2013	1.2999
July 31, 2013	1.3279
August 30, 2013	1.3186
September 30, 2013	1.3537
October 31, 2013	1.3595
November 29, 2013	1.3616
December 31, 2013	1.3779
January 31, 2014	1.3486
February 28, 2014	1.3812
March 31, 2014	1.3782
April 30, 2014	1.3866
May 30, 2014	1.3646
June 30, 2014	1.3692
July 31, 2014	1.3380
August 29, 2014	1.3172
September 30, 2014	1.2633
October 31, 2014	1.2529
November 28, 2014	1.2467
December 31, 2014	1.2101
January 30, 2015	1.1285
February 27, 2015	1.1217
March 31, 2015	1.0740
April 30, 2015	1.1206
May 29, 2015	1.0964
June 30, 2015	1.1142
July 31, 2015	1.1049
August 31, 2015	1.1205
September 30, 2015	1.1163
October 30, 2015	1.1047
November 30, 2015	1.0562
December 31, 2015	1.0863
January 29, 2016	1.0821
February 29, 2016	1.0866
March 31, 2016	1.1396
April 29, 2016	1.1454
May 31, 2016	1.1133
June 30, 2016	1.1110

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

The following graph illustrates the hypothetical performance of the index factor over the period from January 29, 1999 to June 30, 2016, as if the inception date had been January 29, 1999. The graph uses data for the EUR/USD exchange rate and the EONIA for that period. We obtained the level of the EUR/USD exchange rate through December 17, 2008 from the Federal Reserve Bank of New York without independent verification. For all dates following December 17, 2008 we obtained the level of the EUR/USD exchange rate from Bloomberg screen EURUSD WMCO Curncy <GO>, without independent verification. As described in this pricing supplement, the index factor on any given day will be equal to the currency component on that day *times* the accumulation component on that day. The hypothetical performance of the index factor in the following graph should be not interpreted as an indication of the actual or expected performance of the index factor for purposes of the Securities. Moreover, the performance of the index factor alone does not reflect the effect of the investor fee, which will reduce the value of the Securities.

Hypothetical Performance of the Index Factor
January 29, 1999 - June 30, 2016



PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

VALUATION OF THE SECURITIES

The market value of the Securities will be affected by several factors, many of which are beyond our control. We expect that generally changes in the EUR/USD exchange rate will affect the market value of the Securities more than any other factors. Other factors that may influence the market value of the Securities include, but are not limited to, supply and demand for the Securities, interest rates (including especially the EONIA), economic, financial, political, regulatory, geographical or judicial events that affect the EUR/USD exchange rate as well as the perceived creditworthiness of Barclays Bank PLC. See "Risk Factors" in this pricing supplement for a discussion of the factors that may influence the market value of the Securities prior to maturity.

Intraday Indicative Value

An "intraday indicative value" meant to approximate changes in the value of the Securities during the current trading day by reference to the Index, is published for reference purposes only.

The intraday indicative value is intended to provide investors with an approximation of the effect that changes in the performance of the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) during the current trading day would have on the daily redemption value of the Securities from the previous day. Intraday indicative value differs from the daily redemption value in two important respects. First, intraday indicative value is based on the most recent published EUR/USD exchange rate and deposit rate, rather than the Index Factor for the immediately preceding calendar day. Second, the intraday indicative value only reflects the investor fee at the close of business on the preceding calendar day, but does not include any adjustment for the investor fee during the course of the current day.

The intraday indicative value is published as a convenience for reference purposes only and does not represent the actual trading price of the Securities, which may be influenced by bid-offer spreads, hedging and transaction costs and market liquidity, among other factors.

The intraday indicative value is calculated and published by NYSE Euronext (NYSE) or a successor under the ticker symbol ERO.IV.

In connection with your Securities, we use the term "**intraday indicative value**" to refer to the value at a given time on any trading day determined based on the following equation:

Intraday Indicative Value = Principal Amount x (Current Currency Component x Current Accumulation Component) - Current Investor Fee

where:

Principal Amount per Security = $50;

Current Currency Component = The most recent calculation of the currency component, determined as described in this pricing supplement;

Current Accumulation Component = The most recent calculation of the accumulation component, determined as described in this pricing supplement; and

Current Investor Fee = The most recent daily calculation of the investor fee with respect to your Securities, determined as described in this pricing supplement (which, during any trading day, will be the investor fee determined on the preceding calendar day).

NYSE is not affiliated with Barclays Bank PLC and do not approve, endorse, review or recommend Barclays Bank PLC or the Securities.

The intraday indicative value will be derived from sources deemed reliable, but NYSE and its suppliers do not guarantee the correctness or completeness of the intraday indicative value or other information furnished in connection with any series of Securities. NYSE makes no warranty, express or implied, as to results to be obtained by Barclays Bank PLC, Barclays Bank PLC's customers, holders of the Securities, or any other person or entity from the use of the intraday indicative value or any data included therein. NYSE makes no express or implied warranties, and expressly disclaims all warranties of merchantability or fitness for a particular purpose with respect to the intraday indicative value or any data included therein.

NYSE, its employees, subcontractors, agents, suppliers and vendors shall have no liability or responsibility, contingent or otherwise, for any injury or damages, whether caused by the negligence of NYSE, its employees, subcontractors, agents, suppliers or vendors or otherwise, arising in connection with the intraday

indicative value of the Securities, and shall not be liable for any lost profits, losses, punitive, incidental or consequential damages. NYSE shall not be responsible for or have any liability for any injuries or damages caused by errors, inaccuracies, omissions or any other failure in, or delays or interruptions of, the intraday indicative value, from whatever cause. NYSE is not responsible for the selection of or use of any Index or any series of the Securities, the accuracy and adequacy of any Index or information used by Barclays Bank PLC and the resultant output thereof.

The intraday indicative value calculation is not intended as a price or quotation, or as an offer or solicitation for the purchase, sale, redemption or termination of your Securities. The actual trading price of the Securities in the secondary market may vary significantly from their intraday indicative value. See "Risk Factors—Risks Relating to Liquidity and the Secondary Market—The Securities May Trade at a Substantial Premium to or Discount from the Intraday Indicative Value" in this pricing supplement.

Furthermore, as the intraday indicative value is calculated using the daily redemption value on the immediately preceding calendar day, the intraday indicative value published at any time during a given trading day will not reflect the investor fee that may have accrued over the course of such trading day. Published Index levels may occasionally be subject to delay or postponement. Any such delays or postponements will affect the current Index level and therefore the intraday indicative value of your Securities. The actual trading price of the Securities may be different from their intraday indicative value.

SPECIFIC TERMS OF THE SECURITIES

In this section, references to "holders" mean those who own the Securities registered in their own names, on the books that we or the trustee maintain for this purpose, and not those who own beneficial interests in the Securities registered in street name or in the Securities issued in book-entry form through The Depository Trust Company or another depositary. Owners of beneficial interests in the Securities should read the section entitled "Description of Debt Securities – Legal Ownership; Form of Debt Securities" in the accompanying prospectus.

The Securities are part of a series of debt securities entitled "Global Medium-Term Notes, Series A" (the "**medium-term notes**") that we may issue under the indenture, dated September 16, 2004, (the "**indenture**") between Barclays Bank PLC and The Bank of New York Mellon, as trustee, (the "**trustee**"), from time to time. This pricing supplement summarizes specific financial and other terms that apply to the Securities. Terms that apply generally to all medium-term notes are described in "Terms of the Notes" in the accompanying prospectus supplement, and terms that apply generally to all currency-linked notes are described in "Reference Assets – Currency Exchange Rates" in the accompanying prospectus supplement. The terms described here (i.e., in this pricing supplement) supplement those described in the accompanying prospectus, prospectus supplement and any related free writing prospectuses and, if the terms described here are inconsistent with those described in those documents, the terms described here are controlling.

Please note that the information about the price to the public and the proceeds to Barclays Bank PLC on the front cover of this pricing supplement relates only to the initial sale of the Securities. If you have purchased the Securities in a market-making transaction after the initial sale, information about the price and date of sale to you will be provided in a separate confirmation of sale.

We describe the terms of the Securities in more detail below.

Coupon

We will not pay you interest during the term of the Securities.

Denomination

We will offer the Securities in denominations of $50.

Payment at Maturity

If you hold your Securities to maturity, you will receive a cash payment at maturity that is linked to the percentage change in the EUR/USD exchange rate between the inception date and the final valuation date. Your cash payment at maturity will be equal to (1) the principal amount

of your Securities *times* (2) the index factor on the final valuation date *minus* (3) the investor fee on the final valuation date.

The currency component on any given day will be equal to the EUR/USD exchange rate on that day (or, if such day is not a trading day, the EUR/USD exchange rate on the immediately preceding trading day) *divided by* the EUR/USD exchange rate on the inception date.

The accumulation component will be calculated on a daily basis in the following manner: The accumulation component on the inception date will equal one. On each subsequent business day until maturity or early redemption, the accumulation component will equal (1) the accumulation component on the immediately preceding business day *times* (2) the sum of one *plus* the product of the deposit rate *times* the relevant daycount fraction.

The index factor on any given day will be equal to the currency component on that day *times* the accumulation component on that day.

The deposit rate on any given day is the EONIA *minus* 0.25%. The deposit rate is intended to represent the actual rate that would be paid by a bank on an overnight deposit of euros.

The daycount fraction on any business day will be the number of calendar days that have elapsed since the immediately preceding business day *divided by* 365.

The investor fee is equal to 0.40% per year *times* the principal amount of your Securities *times* the index factor, calculated on a daily basis in the following manner: The investor fee on the inception date will equal zero. On each subsequent calendar day until maturity or early redemption, the investor fee will increase by an amount equal to (1) 0.40% *times* (2) the principal amount of your Securities *times* (3) the index factor on that day (or, if such day is not a trading day, the index factor on the immediately preceding trading day) *divided by* (4) 365. Because the investor fee reduces the amount of your return at maturity or upon redemption, the value of the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) must increase significantly in order for you to receive at least the principal amount of your investment at maturity or upon redemption. If the value of the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) decreases or does not increase sufficiently, you will receive less than the principal amount of your investment at maturity or upon redemption.

Maturity Date

If the maturity date stated on the cover of this pricing supplement is not a business day, the maturity date will be the next following business day. If the fifth business day before this day does not qualify as a valuation date (as described below), then the maturity date will be the fifth business day following the final valuation date.

In the event that payment at maturity is deferred beyond the stated maturity date, penalty interest will not accrue or be payable with respect to that deferred payment.

Payment Upon Redemption

Prior to maturity, you may, subject to certain restrictions, choose to redeem your Securities on any redemption date during the term of the Securities. If you redeem your Securities on a particular redemption date, you will receive a cash payment on such date in an amount equal to the daily redemption value, which equals (1) the principal amount of your Securities *times* (2) the index factor on the applicable valuation date *minus* (3) the investor fee on the applicable valuation date. You must redeem at least 50,000 Securities at one time in order to exercise your right to redeem your Securities on any redemption date. We may from time to time in our sole discretion reduce, in part or in whole, the minimum redemption amount of 50,000 Securities. Any such reduction will be applied on a consistent basis for all holders of Securities at the time the reduction becomes effective.

A valuation date is each business day from May 17, 2007 to May 7, 2037, inclusive (subject to the occurrence of a market disruption event), or, if such date is not a trading day, the next succeeding trading day, not to exceed five business days. We refer to Thursday, May 7, 2037 as the “final valuation date”.

A redemption date is the third business day following a valuation date (other than the final valuation date). The final redemption date will be the third business day following the valuation date immediately prior to the final valuation date.

In the event that payment upon redemption is deferred beyond the original redemption date, penalty interest will not accrue or be payable with respect to that deferred payment.

Redemption Procedures

You may, subject to the minimum redemption amount described above, elect to redeem your Securities on any redemption date. To redeem your Securities, you must instruct your broker or other person with whom you hold your Securities to take the following steps:

- deliver a notice of redemption, which is attached as Annex A, to us via facsimile or email by no later than 4:00 p.m., New York City time, on the business day prior to the applicable valuation date. If we receive your notice by the time specified in the preceding sentence, we will respond by sending you a form of confirmation of redemption, which is attached as Annex B;
- deliver the signed confirmation of redemption to us via facsimile or email in the specified form by 5:00 p.m., New York City time, on the same day. We or our affiliate must acknowledge receipt in order for your confirmation to be effective;
- instruct your DTC custodian to book a delivery vs. payment trade with respect to your Securities on the valuation date at a price equal to the applicable daily redemption value, facing Barclays DTC 5101; and
- cause your DTC custodian to deliver the trade as booked for settlement via DTC at or prior to 10:00 a.m., New York City time, on the applicable redemption date (the third business day following the valuation date).

Different brokerage firms may have different deadlines for accepting instructions from their customers. Accordingly, you should consult the brokerage firm through which you own your interest in the Securities in respect of such deadlines. If we do not receive your notice of redemption by 4:00 p.m., New York City time, or your confirmation of redemption by 5:00 p.m., New York City time, on the business day prior to the applicable valuation date, your notice will not be effective and we will not redeem your Securities on the applicable redemption date. Any redemption instructions for which we (or our affiliate) receive a valid confirmation in accordance with the procedures described above will be irrevocable.

The redemption value is determined according to a formula which relies upon the daily redemption value and will be calculated on a valuation date that will occur after the redemption notice is submitted. It is not possible to publicly disclose, or for you to determine, the precise redemption value prior to your election to redeem. The redemption value may be below the most recent intraday indicative value or daily redemption value of your Securities at the time when you submit your redemption notice.

Default Amount on Acceleration

If an event of default occurs and the maturity of the Securities is accelerated, we will pay the default amount in respect of the principal of the Securities at maturity. We describe the default amount below under "– Default Amount".

For the purpose of determining whether the holders of our medium-term notes, of which the Securities are a part, are entitled to take any action under the indenture, we will treat the stated principal amount of each Security outstanding as the principal amount of that Security. Although the terms of the Securities may differ from those of the other medium-term notes, holders of specified percentages in principal amount of all medium-term notes, together in some cases with other series of our debt securities, will be able to take action affecting all the medium-term notes, including the Securities. This action may involve changing some of the terms that apply to the medium-term notes, accelerating the maturity of the medium-term notes after a default or waiving some of our obligations under the indenture. We discuss these matters in the attached prospectus under "Description of Debt Securities – Modification and Waiver" and "– Senior Events of Default; Subordinated Events of Default and Defaults; Limitations of Remedies".

Default Amount

The default amount for the Securities on any day will be an amount, determined by the calculation agent in its sole discretion, equal to the cost of having a qualified financial institution, of the kind and selected as described below, expressly assume all our payment and other obligations

with respect to the Securities as of that day and as if no default or acceleration had occurred, or to undertake other obligations providing substantially equivalent economic value to you with respect to the Securities. That cost will equal:

- the lowest amount that a qualified financial institution would charge to effect this assumption or undertaking, plus
- the reasonable expenses, including reasonable attorneys' fees, incurred by the holders of the Securities in preparing any documentation necessary for this assumption or undertaking.

During the default quotation period for the Securities, which we describe below, the holders of the Securities and/or we may request a qualified financial institution to provide a quotation of the amount it would charge to effect this assumption or undertaking. If either party obtains a quotation, it must notify the other party in writing of the quotation. The amount referred to in the first bullet point above will equal the lowest – or, if there is only one, the only – quotation obtained, and as to which notice is so given, during the default quotation period. With respect to any quotation, however, the party not obtaining the quotation may object, on reasonable and significant grounds, to the assumption or undertaking by the qualified financial institution providing the quotation and notify the other party in writing of those grounds within two business days after the last day of the default quotation period, in which case that quotation will be disregarded in determining the default amount.

Default Quotation Period

The default quotation period is the period beginning on the day the default amount first becomes due and ending on the third business day after that day, unless:

- no quotation of the kind referred to above is obtained, or
- every quotation of that kind obtained is objected to within five business days after the due date as described above.

If either of these two events occurs, the default quotation period will continue until the third business day after the first business day on which prompt notice of a quotation is given as described above. If that quotation is objected to as described above within five business days after that first business day, however, the default quotation period will continue as described in the prior sentence and this sentence.

In any event, if the default quotation period and the subsequent two business day objection period have not ended before the final valuation date, then the default amount will equal the principal amount of the Securities.

Qualified Financial Institutions

For the purpose of determining the default amount at any time, a qualified financial institution must be a financial institution organized under the laws of any jurisdiction in the United States of America or Europe, which at that time has outstanding debt obligations with a stated maturity of one year or less from the date of issue and rated either:

- A-1 or higher by Standard & Poor's Ratings Services, or any successor, or any other comparable rating then used by that rating agency, or
- P-1 or higher by Moody's Investors Service, or any successor, or any other comparable rating then used by that rating agency.

Further Issuances

We may, without your consent, create and issue additional securities having the same terms and conditions as the Securities. If there is substantial demand for the Securities, we may issue additional Securities frequently. We may consolidate the additional securities to form a single class with the outstanding Securities. However, we are under no obligation issue additional Securities. We also reserve the right to cease or suspend sales of Securities from inventory held by our affiliate Barclays Capital Inc. at any time.

Note Market Disruption Events

A valuation date may be postponed and thus the determination of the Index levels may be postponed if the calculation agent determines that, on the respective date, a market disruption event has occurred or is continuing in respect of the Index.

Any of the following will be a market disruption event with respect to the Index:

- any event or any condition (including without limitation any event or condition that occurs as a result of the enactment, promulgation, execution, ratification, interpretation or application of, or any change in or amendment to, any law, rule or regulation by any applicable governmental authority) that results in an illiquid market for currency transactions or that generally makes it impossible, illegal or impracticable for market participants, or hinders their abilities, (1) to convert from one foreign currency to another through customary commercial channels, (2) to effect currency transactions or (3) to obtain the currency exchange rate by reference to the applicable price source;
- (1) the declaration of a banking moratorium or (2) the suspension of payments by banks, in either case (1) or (2), in the country of any currency used to determine the applicable currency exchange rate or (3) the declaration of capital and/or currency controls (including without limitation any restriction placed on assets in or transactions through any account through which a non-resident of the country of any currency used to determine the applicable currency exchange rate may hold assets or transfer monies outside the country of that currency, and any restriction on the transfer of funds, securities or other assets of market participants from within or outside of the country of any currency used to determine the applicable currency exchange rate),

and, in any of these events, the calculation agent determines that the event was material.

"Scheduled trading day" means any day on which (1) the applicable currency exchange rate is reported on the relevant Bloomberg page, Reuters screen or other pricing source specified in this pricing supplement, and (2) trading is generally conducted in the interbank market, in each case as determined by the calculation agent in its sole discretion.

If the calculation agent determines that a market disruption event occurs or is continuing on any valuation date, the valuation date will be the first following scheduled trading day on which the calculation agent determines that a market disruption event does not occur and is not continuing. In no event, however, will the valuation date be postponed by more than five scheduled trading days. If the calculation agent determines that a market disruption event occurs or is continuing on the fifth scheduled trading day, the calculation agent will make an estimate of the closing level for the Index that would have prevailed on that fifth scheduled trading day in the absence of the market disruption event.

Manner of Payment and Delivery

Any payment on or delivery of the Securities at maturity will be made to accounts designated by you and approved by us, or at the office of the trustee in New York City, but only when the Securities are surrendered to the trustee at that office. We also may make any payment or delivery in accordance with the applicable procedures of the depositary.

Business Day

When we refer to a business day with respect to the Securities, we mean a Monday, Tuesday, Wednesday, Thursday or Friday that is not a day on which banking institutions in London or New York City generally are authorized or obligated by law, regulation or executive order to close.

Role of Calculation Agent

Currently, we serve as the calculation agent. We may change the calculation agent without notice. The calculation agent will, in its sole discretion, make all determinations regarding the value of the Securities, including at maturity or upon redemption, business days, trading days, the index factor, the accumulation component, the default amount, the EUR/USD exchange rate on the inception date and on any valuation date, the currency component, the deposit rate, the EONIA, the investor fee, the maturity date, redemption dates, the amount payable in respect of your Securities at maturity or upon redemption and any other calculations or determinations to be made by the calculation agent as specified herein. Absent manifest error, all determinations of the calculation agent will be final and binding on you and us, without any liability on the part of the calculation agent. You will not be entitled to any compensation from us for any loss suffered as a result of any of the above determinations by the calculation agent.

CLEARANCE AND SETTLEMENT

Depository Trust Company ("DTC") participants that hold the Securities through DTC on behalf of investors will follow the settlement practices applicable to equity securities in DTC's settlement system with respect to the primary distribution of the Securities and secondary market trading between DTC participants.

USE OF PROCEEDS AND HEDGING

We will use the net proceeds we receive from the sale of the Securities for the purposes we describe in the attached prospectus supplement under "Use of Proceeds and Hedging". We or our affiliates may also use those proceeds in transactions intended to hedge our obligations under the Securities as described below.

In anticipation of the sale of the Securities, we or our affiliates expect to enter into hedging transactions involving purchases of U.S. dollars or euros or instruments linked to the U.S. dollar, the euro or the EUR/USD exchange rate prior to or on the inception date. In addition, from time to time after we issue the Securities, we or our affiliates may enter into additional hedging transactions or unwind those hedging transactions we have entered into. In this regard, we or our affiliates may:

- acquire or dispose of long or short positions in listed or over-the-counter options, futures, or other instruments linked to the U.S. dollar or the euro or the EUR/USD exchange rate;
- acquire or dispose of long or short positions in listed or over-the-counter options, futures, or other instruments linked to other similar exchange rates or currencies; or
- any combination of the above two.

We or our affiliates may acquire a long or short position in securities similar to the Securities from time to time and may, in our or their sole discretion, hold or resell those securities.

We or our affiliates may close out our or their hedge positions on or before the final valuation date. That step may involve sales or purchases of listed or over-the-counter options or futures on the U.S. dollar or the euro or listed or over-the-counter options, futures, or other instruments linked to the U.S. dollar or the euro or the EUR/USD exchange rate, as well as other instruments designed to track the performance of the EUR/USD exchange rate or other currencies.

The hedging activity discussed above may have a positive effect on the EUR/USD exchange rate and, as a consequence, a negative effect on the market value of the Securities from time to time and the amount payable at maturity or upon redemption. See "Risk Factors" in this pricing supplement for a discussion of possible adverse effects related to our hedging activities.

MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS

The following section supplements the discussion of U.S. federal income taxation in the accompanying prospectus supplement and is the opinion of Sullivan & Cromwell LLP, our counsel. Except for the discussion under the heading "Non-U.S. Holders" below, it applies to you only if you are a U.S. holder (as defined below) and you hold your Securities as capital assets for tax purposes. This section does not apply to you if you are a member of a class of holders subject to special rules, such as:

- a dealer in securities or currencies;
- a trader in securities that elects to use a mark-to-market method of accounting for your securities holdings;
- a bank;
- a life insurance company;
- a tax-exempt organization;
- a regulated investment company;
- a partnership or other pass-through entity;
- a person that owns a Security as a hedge or that is hedged against interest rate or currency risks;
- a person that owns a Security as part of a straddle or conversion transaction for tax purposes; or
- a U.S. holder (as defined below) whose functional currency for tax purposes is not the U.S. dollar.

This section is based on the U.S. Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations under the Internal Revenue Code, published rulings and court decisions, all as

currently in effect. These laws are subject to change, possibly on a retroactive basis.

You should consult your tax advisor concerning the U.S. federal income tax and other tax consequences of your investment in the Securities in your particular circumstances, including the application of state, local or other tax laws and the possible effects of changes in federal or other tax laws.

Except for the discussion under the heading "Non-U.S. Holders" below, this section describes the tax consequences to a U.S. holder. You are a U.S. holder if you are a beneficial owner of a Security and you are for U.S. federal income tax purposes:

- a citizen or resident of the United States;
- a domestic corporation;
- an estate whose income is subject to U.S. federal income tax regardless of its source; or
- a trust if a U.S. court can exercise primary supervision over the trust's administration and one or more U.S. persons are authorized to control all substantial decisions of the trust.

Pursuant to Revenue Ruling 2008-1, the Securities should be treated as debt instruments denominated in euros. The tax treatment of your Securities may depend upon whether the Securities are properly treated as variable rate debt instruments, and this may depend upon whether or not it is reasonably expected that the average rate of return on the Securities during the first half of the Securities' term will be significantly greater or less than the average rate of return on the Securities during the second half of the Securities' term ("Front or Back-Loaded"). The Issuer believes that the Securities should not be treated as Front or Back-Loaded and intends to report payments on the Securities in accordance with such position. Unless otherwise stated, the discussion below assumes that the Securities will not be Front or Back-Loaded.

Based in part on the fact that the accumulation component compounds on the Securities at least annually, the Securities should be treated as variable rate debt instruments subject to the original issue discount rules applicable to foreign currency-denominated notes, notwithstanding the fact that you will not receive any payments on the Securities until early redemption or maturity. Under those rules, you must include OID in your gross income for federal income tax purposes as it accrues (regardless of your method of accounting), even though you will not receive cash attributable to that income until the sale, early redemption or maturity of your Securities. In general, the effect of these rules is that you should be required to accrue an amount of OID with respect to your Securities for each taxable year that is equal to the accumulation component for that year minus the investor fee that accrued in such year.

More specifically, the amount of OID that you must include in income is calculated using a constant-yield method, and generally you will be required to include increasingly greater amounts of OID in income over the term of the Securities. You must determine OID for any accrual period in euros in the manner described below, and then translate the euro amount of OID into U.S. dollars. While it is not entirely clear, the amount of OID that accrues on each Security should be determined by assuming that the Security bears interest at a fixed rate that is equal to the yield that was reasonably expected for the Security as of the issue date for the Security (the "assumed fixed rate").

However, as discussed below, the amount of the assumed fixed rate will have no consequence as long as the last day of your taxable year is also the last day of an accrual period in respect of the Securities. The annual amount of OID that you must include in income will equal the "daily portions" of the OID with respect to each Security for each day during the taxable year or portion of the taxable year that you hold the Security. Generally, the daily portions of OID are determined by allocating to each day in an "accrual period" the ratable portion of the OID allocable to the accrual period. The term accrual period means an interval of time with respect to which the accrual of OID is measured, and it may vary in length over the term of your Security. However, no accrual period may be longer than one year.

For purposes of accruing OID, all accrued amounts will initially be calculated in euros. The amount of OID allocable to an accrual period will be equal to the product of the "adjusted issue price" of the Security at the beginning of the accrual period and its "yield to maturity". The adjusted issue price of the Security at the

beginning of the first accrual period is its issue price and, on any day thereafter, is the sum of the issue price and the amount of OID that previously accrued in respect of the Securities. The issue price of each Security will be equal to the amount of euros that could have been purchased with $50 on the issue date. The yield to maturity is computed on the basis of compounding at the end of each accrual period and on the assumption that the Security bears interest at the assumed fixed rate. The amount of OID allocable to any accrual period must be increased (or decreased) if the OID that actually accrues during that accrual period (i.e., the accumulation component minus the investor fee for such period) exceeds (or is less than) the OID accrued on the basis of the assumed fixed rate. Thus, if you have an accrual period that ends on the last day of the taxable year, the total amount of OID that you will include in a taxable year will be equal to the accumulation component minus the investor fee, irrespective of the assumed fixed rate.

If the OID that actually accrued during an accrual period is a negative amount (because the investor fee exceeds the accumulation component for such period), it is unclear whether and when you should be able to deduct such negative amounts or offset such negative amounts against prior or future OID accruals in respect of your Securities. In such a case, you should consult your tax advisor on how to treat such amount.

You may determine the U.S. dollar amount of OID that you recognize in any accrual period by using one of two methods. Under the default method, the U.S. dollar amount of accrued OID is determined based on the average EUR/USD exchange rate for the accrual period (or, with respect to an accrual period that spans two taxable years, the partial period within the taxable year). If you elect (or have previously elected and such election is still in effect) the second method, you would determine the U.S. dollar amount of OID accrued on the basis of the EUR/USD spot rate on the last day of the accrual period (or, in the case of a partial accrual period, the EUR/USD spot rate on the last day of the taxable year) or, if the last day of an accrual period is within five business days of the receipt of payment in respect of such OID, the spot rate on the date of receipt. If you elect the second method, it will apply to all debt instruments that you hold at the beginning of the first taxable year to which the election applies and to all debt instruments that you subsequently acquire. You may not revoke this election without the consent of the Internal Revenue Service.

Exchange gain or loss is determined when OID is considered paid (i.e., upon sale, early redemption or maturity of your Securities), to the extent that the exchange rate on the date of payment differs from the exchange rate at which the OID was accrued. Any exchange gain or loss will generally be treated as U.S. source ordinary income or loss. Exchange gain or loss will only be recognized to the extent of the total gain or loss you recognize with respect to your Securities.

You will generally recognize gain or loss upon the sale, early redemption or maturity of your Securities in an amount equal to the difference between the amount you receive at such time and your tax basis in the Securities. In general, your tax basis in your Securities will be the U.S. dollar cost of your Securities, adjusted by adding any OID or market discount that you previously included in income with respect to your Securities and decreased by any amortizable bond premium applied to reduce interest on your Securities. The gain or loss would be capital gain or loss, except to the extent that it is attributable to changes in the EUR/USD exchange rate over the term of your Securities. Capital gain of a noncorporate U.S. holder is generally taxed at preferential rates in cases where the holder has a holding period of greater than one year.

It is possible that the Internal Revenue Service could assert that your holding period in respect of your Securities should end on the date on which the amount you are entitled to receive upon the early redemption or maturity of your Securities is determined, even though you will not receive any amounts from the Issuer in respect of your Securities prior to the early redemption or maturity of your Securities. In such a case, you may be treated as having a holding period in respect of your Securities that is less than one year even if you receive cash upon the early redemption or maturity of your Securities at a time that is more than one year after the beginning of your holding period.

If you acquire your Securities in the secondary market, special rules applicable to market discount, amortizable bond premium and

acquisition premium may apply to you. For a further explanation of these rules, please see the discussion under the headings "Material U.S. Federal Income Tax Considerations—Tax Consequences to U.S. Holders—Notes Treated as Indebtedness for U.S. Federal Income Tax Purposes—Market Discount", "Material U.S. Federal Income Tax Considerations—Tax Consequences to U.S. Holders—Notes Treated as Indebtedness for U.S. Federal Income Tax Purposes—Acquisition Premium and Amortizable Bond Premium" and "Material U.S. Federal Income Tax Consequences—Tax Consequences to U.S. Holders—Notes Treated as Indebtedness for U.S. Federal Income Tax Purposes—Foreign Currency Notes" in the accompanying prospectus supplement.

If, contrary to the assumption above, the Securities are treated as Front or Back-Loaded, the Securities may be subject to the special contingent payment debt rules applicable to foreign-currency denominated debt instruments that provide for currency-based contingencies.

In addition, the Internal Revenue Service could potentially assert that you should be required to treat amounts attributable to the investor fee as amounts of expense. Under this alternative treatment, such amounts which would generally be subject to the 2% floor on miscellaneous itemized deductions and would increase the amount of gain or decrease the amount of loss that you recognize with respect to your Securities.

In addition, it is possible that you could be required to recognize gain or loss at any time when the Index is modified, adjusted, discontinued or replaced with a successor index.

We urge you to consult your tax advisor in determining the tax consequences of an investment in your Securities in your particular circumstances, including the application of state, local or other tax laws and the possible effects of changes in federal or other tax laws.

Treasury Regulations Requiring Disclosure of Reportable Transactions

Treasury regulations require U.S. taxpayers to report certain transactions that give rise to a loss in excess of certain thresholds. Under these regulations, a U.S. holder that recognizes a loss with respect to the Securities that is attributable to changes in the spot exchange rate of a foreign currency will be required to report the loss on Internal Revenue Service Form 8886 if such loss exceeds the thresholds set forth in the regulations. For individuals and trusts, this loss threshold is $50,000 in any single taxable year. For other types of taxpayers and other types of losses, the thresholds are higher. You should consult your tax advisor regarding any tax filing and reporting obligations that ought to be made in connection with any loss realized in connection with acquiring, owning and disposing of Securities.

"Specified Foreign Financial Asset" Reporting

Owners of "specified foreign financial assets" with an aggregate value in excess of $50,000 (and in some circumstances, a higher threshold) may be required to file an information report with respect to such assets with their tax returns. "Specified foreign financial assets" may include any financial accounts maintained by foreign financial institutions, as well as any of the following but only if they are held for investment and not held in accounts maintained by financial institutions: (i) stocks and securities issued by non-U.S. persons, (ii) financial instruments and contracts that have non-U.S. issuers or counterparties and (iii) interests in foreign entities. The Securities may be subject to these rules. Holders are urged to consult their tax advisors regarding the application of this reporting requirement to their ownership of the Securities.

Non-U.S. Holders

We currently do not withhold on payments treated as interest to non-U.S. holders in respect of instruments such as the Securities. However, if we determine that there is a material risk that we will be required to withhold on any such payments, we may withhold on any payments treated as interest at a 30% rate, unless you have provided to us an appropriate and valid Internal Revenue Service Form W-8. In addition, non-U.S. holders will be subject to the general rules regarding information reporting and backup withholding as described under the heading "Material U.S. Federal Income Tax Consequences— Information Reporting and Backup Withholding " in the accompanying prospectus supplement.

Information Reporting and Backup Withholding

Please see the discussion under "Material U.S. Federal Income Tax Consequences–Information

Reporting and Backup Withholding" in the accompanying prospectus supplement for a description of the applicability of the information reporting and backup withholding rules to payments made on your Securities.

SUPPLEMENTAL PLAN OF DISTRIBUTION

We sold a portion of the Securities on the inception date at 100% of their stated principal amount. The remainder of the Securities will be offered and sold from time to time through Barclays Capital Inc., our affiliate, as agent. Sales of the Securities after the inception date will be made at market prices prevailing at the time of sale, at prices related to market prices or at negotiated prices. Barclays Capital Inc. will not receive an agent's commission in connection with sales of the Securities.

In connection with this offering, we will sell the Securities to dealers as principal, and such dealers may then resell Securities to the public at varying prices that the dealers will determine at the time of resale. In addition, such dealers may make a market in the Securities, although none of them are obligated to do so and any of them may stop doing so at any time without notice. This prospectus (including this pricing supplement and the accompanying prospectus and prospectus supplement) may be used by such dealers in connection with market-making transactions. In these transactions, dealers may resell a Security covered by this prospectus that they acquire from other holders after the original offering and sale of the Securities, or they may sell a Security covered by this prospectus in short sale transactions.

Broker-dealers and other persons are cautioned that some of their activities may result in their being deemed participants in the distribution of the Securities in a manner that would render them statutory underwriters and subject them to the prospectus delivery and liability provisions of the Securities Act of 1933, as amended (the "**Securities Act**"). Among other activities, broker-dealers and other persons may make short sales of the Securities and may cover such short positions by borrowing Securities from us or our affiliates or by purchasing Securities from us or our affiliates subject to our obligation to repurchase such Securities at a later date. As a result of these activities, these market participants may be deemed statutory underwriters. A determination of whether a particular market participant is an underwriter must take into account all the facts and circumstances pertaining to the activities of the participant in the particular case, and the example mentioned above should not be considered a complete description of all the activities that would lead to designation as an underwriter and subject a market participant to the prospectus-delivery and liability provisions of the Securities Act. This prospectus will be deemed to cover any short sales of Securities by market participants who cover their short positions with Securities borrowed or acquired from us or our affiliates in the manner described above.

ANNEX A

NOTICE OF REDEMPTION

To: [ipathredemptions@barclays.com]

Subject: iPath® Notice of Redemption, CUSIP No. 06739F184

[BODY OF EMAIL]

Name of holder: [ ]

Number of Securities to be redeemed: [ ]

Applicable Valuation Date: [ ], 20[ ]

Contact Name: [ ]

Telephone #: [ ]

Acknowledgement: I acknowledge that the Securities specified above will not be redeemed unless all of the requirements specified in the pricing supplement relating to the Securities are satisfied.

ANNEX B

CONFIRMATION OF REDEMPTION

Dated:

Barclays Bank PLC

Barclays Bank PLC, as Calculation Agent

Fax: 212-412-1232

Dear Sir/Madam:

The undersigned holder of Barclays Bank PLC's $250,000,000 Global Medium-Term Notes, Series A, iPath® Exchange-Traded Notes due May 14, 2037 CUSIP No. 06739F184, redeemable for a cash amount based on the EUR/USD exchange rate (the "Securities") hereby irrevocably elects to exercise, on the redemption date of _____, with respect to the number of Securities indicated below, as of the date hereof, the redemption right as described in the prospectus relating to the Securities (the "Prospectus"). Terms not defined herein have the meanings given to such terms in the Prospectus.

The undersigned certifies to you that it will (i) instruct its DTC custodian with respect to the Securities (specified below) to book a delivery vs. payment trade on the valuation date with respect to the number of Securities specified below at a price per Security equal to the applicable daily redemption value, facing Barclays DTC 5101 and (ii) cause the DTC custodian to deliver the trade as booked for settlement via DTC at or prior to 10:00 a.m., New York City time, on the redemption date.

Very truly yours,
[NAME OF HOLDER]

_____

Name:
Title:
Telephone:
Fax:
E-mail:

Number of Securities surrendered for redemption:_____

DTC # (and any relevant sub-account): _____
Contact Name:
Telephone:

(You must redeem at least 50,000 Securities at one time in order to exercise your right to redeem your Securities on any redemption date.)

Filed Pursuant to Rule 424(b)(3)
Registration No. 333-212571

Prospectus Supplement to the Prospectus dated July 18, 2016

BARCLAYS BANK PLC
GLOBAL MEDIUM-TERM NOTES, SERIES A
UNIVERSAL WARRANTS

We will give you the specific terms of the notes and warrants (each, a "security" and together, the "securities") we are offering in pricing supplements. In some cases, we may also set forth additional terms of the securities in a prospectus supplement, which we refer to as a "product supplement," and we may also describe certain of the potential indices to which the securities are linked in a prospectus supplement, which we refer to as an "index supplement." You should read this prospectus supplement, the related prospectus dated July 18, 2016, the applicable product supplement(s) or index supplement(s), if any, and the applicable pricing supplement carefully before you invest. If the terms described in the applicable product supplement are different from or inconsistent with those described in this prospectus supplement, in the prospectus or in any applicable index supplement, the terms described in the applicable product supplement will control. If the terms described in the applicable pricing supplement are different from or inconsistent with those described in this prospectus supplement, in the prospectus, in any applicable product supplement or any applicable index supplement, the terms described in the applicable pricing supplement will control. Information that we indicate in this prospectus supplement will or may be provided in a pricing supplement may instead be provided in a product supplement or a free writing prospectus.

The Securities

Reference Asset. The principal, interest or any other amounts payable on or any other property deliverable in respect of the notes, and the amount of money or warrant property payable or deliverable in respect of the warrants, may be based on, as applicable, one or more of the following or on movements in the level(s), value(s) or price(s) of, or other events relating to, one or more of the following: equity securities, shares or other interests in exchange-traded funds, exchange-traded notes, commodities, currencies, interest rates, indices of any of the foregoing or any combination thereof, indices of consumer prices or other asset classes. In addition, any amounts payable or property deliverable on the securities may be based on measures, formulas or instruments, including those related to macroeconomic events or indicators or the occurrence or nonoccurrence of any event or circumstance, or baskets composed of any instruments or measures, as specified in the applicable pricing supplement. We refer to each of the assets, instruments or measures on which payments on the securities may be based as a "reference asset."

Ranking. The securities constitute direct, unconditional, unsecured and unsubordinated obligations of Barclays Bank PLC ranking *pari passu*, without any preference among themselves, with all our other outstanding unsecured and unsubordinated obligations, present and future, except those obligations as are preferred by operation of law.

Listing. Unless otherwise specified in the applicable pricing supplement, the securities will not be listed on any U.S. securities exchange or quotation system.

Agreement with Respect to the Exercise of U.K. Bail-in Power. Notwithstanding any other agreements, arrangements or understandings between Barclays Bank PLC and any holder of the securities, by acquiring the securities, each holder of the securities acknowledges, accepts, agrees to be bound by, and consents to the exercise of, any U.K. Bail-in Power (as defined below) by the relevant U.K. resolution authority (as defined below) that may result in (i) the reduction or cancellation of all, or a portion, of the principal amount of, interest on, or any other amounts payable on, the securities; (ii) the conversion of all, or a portion, of the principal amount of, interest on, or any other amounts payable on, the securities into shares or other securities or other obligations of Barclays Bank PLC or another person (and the issue to, or conferral on, the holder of the securities such shares, securities or obligations); and/or (iii) the amendment or alteration of the maturity of the securities, or amendment of the amount of interest or any other amounts due on the securities, or the dates on which interest or any other amounts become payable, including by suspending payment for a temporary period; which U.K. Bail-in Power may be exercised by means of a variation of the terms of the securities solely to give effect to the exercise by the relevant U.K. resolution authority of such U.K. Bail-in Power. Each holder of the securities further acknowledges and agrees that the rights of the holders of the securities are subject to, and will be varied, if necessary, solely to give effect to, the exercise of any U.K. Bail-in Power by the relevant U.K. resolution authority. For the avoidance of doubt, this consent and acknowledgment is not a waiver of any rights holders of the securities may have at law if and to the extent that any U.K. Bail-in Power is exercised by the relevant U.K. resolution authority in breach of laws applicable in England.

For these purposes, a "U.K. Bail-in Power" is any write-down, conversion, transfer, modification and/or suspension power existing from time to time under any laws, regulations, rules or requirements relating to the resolution of banks, banking group companies, credit institutions and/or investment firms incorporated in the United Kingdom in effect and applicable in the United Kingdom to Barclays Bank PLC or other members of the Group (as defined below), including but not limited to any such laws, regulations, rules or requirements that are implemented, adopted or enacted within the context of any applicable European Union directive or regulation of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and/or within the context of a U.K. resolution regime under the Banking Act (as defined below), pursuant to which obligations of a bank, banking group company, credit institution or investment firm or any of its affiliates can be reduced, cancelled, amended, transferred and/or converted into shares or other securities or obligations of the obligor or any other person (and a reference to the "relevant U.K. resolution authority" is to any authority with the ability to exercise a U.K. Bail-in Power). See "U.K. Bail-in Power" and "Risk Factors—Risks Relating to the Securities Generally—Regulatory action in the event a bank or investment firm in the Group is failing or likely to fail could materially adversely affect the value of the securities" and "—Under the terms of the securities, you have agreed to be bound by the exercise of any U.K. Bail-in Power by the relevant U.K. resolution authority" in this prospectus supplement.

Global Medium-Term Notes, Series A

Principal Payment at Maturity. The applicable pricing supplement will specify the maturity date. If you hold your notes to maturity, for each note you will receive a cash payment that may be more or less than the principal amount of each note based upon the value of the reference asset and as described in the applicable pricing supplement.

Interest Rates and Interest Payments. The notes may have a rate of interest based on, or contingent on the performance of, (1) one or more reference assets, (2) a fixed amount or rate or (3) movements in the level, value or price or other events relating to one or more reference assets. In the case of any notes that do not bear interest at a fixed rate, any return on the notes that may be deemed to be interest will in no event be higher than the maximum rate permitted by New York law, as it may be modified by U.S. law of general application. See "Terms of the Notes—Interest" in this prospectus supplement.

Redemption, Repayment, Repurchase or Exchange. Terms of specific notes described in the applicable pricing supplement may permit or require redemption for cash or one or more reference assets at our option or at your option. The notes may permit or require repayment or repurchase at our option or at your option. The notes may be optionally or mandatorily exchangeable for cash or one or more reference assets.

Universal Warrants

Type of Warrant. The applicable pricing supplement will specify whether the warrants are call warrants, put warrants or any other type of warrant, and how the warrants will be settled. Call warrants are warrants that entitle the holder to purchase warrant property at the applicable exercise price or to receive the cash value of the warrant property by paying the applicable exercise price, if any. Put warrants are warrants that entitle the holder to sell warrant property at the applicable exercise price or to receive the cash value of the exercise price by tendering the warrant property or its cash value.

Payment or Delivery upon Exercise. If you exercise your warrants on the exercise date or during the exercise period, as applicable, for each warrant you will receive a cash payment or warrant property that may be worth more or less than the issue price of your warrant based upon the value of the reference asset and as described in the applicable pricing supplement.

Exercise Date or Exercise Period. The applicable pricing supplement will specify the exercise date or exercise period, as applicable.

Redemption or Repurchase. Terms of specific warrants described in the applicable pricing supplement may permit or require redemption or repurchase for cash or warrant property at our option.

See "Risk Factors" beginning on page S-7 of this prospectus supplement for risks relating to an investment in the securities.

Any amount payable or property deliverable on the securities is not guaranteed by any third party and is subject to both the creditworthiness of Barclays Bank PLC and to the exercise of any U.K. Bail-in Power (as described below) by the relevant U.K. resolution authority.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined that this prospectus supplement is truthful or complete. Any representation to the contrary is a criminal offense.

The securities are not deposit liabilities of either Barclays PLC or Barclays Bank PLC and are not covered by the U.K. Financial Services Compensation Scheme or insured by the U.S. Federal Deposit Insurance Corporation or any other governmental agency or deposit insurance agency of the United States, the United Kingdom or any other jurisdiction.

Barclays Capital Inc. and other entities disclosed in the applicable pricing supplement may solicit offers to subscribe for the securities as our agent. We may also issue securities to any agent as principal for its own account at prices to be agreed upon at the time of subscription. The agents may resell any securities they subscribe for as principal for their own accounts at prevailing market prices, or at other prices, as the agents determine. The applicable pricing supplement will disclose the agent's discounts and commissions, if any. **Unless we or our agent informs you otherwise in the confirmation of sale, the agents may also use this prospectus supplement, the prospectus, any applicable index supplement, the applicable pricing supplement and any applicable product supplement in connection with offers and sales of the securities in market-making transactions.**

BofA Merrill Lynch

July 18, 2016

TABLE OF CONTENTS

PROSPECTUS SUPPLEMENT

PROSPECTUS

Offers and sales of the securities are subject to restrictions in certain jurisdictions. The distribution of this prospectus supplement, the prospectus, any product supplement, any index supplement and any pricing supplement and the offer or sale of the securities in certain other jurisdictions may be restricted by law. Persons who come into possession of this prospectus supplement, the prospectus, any product supplement, any index supplement and any pricing supplement or any security must inform themselves about and observe any applicable restrictions on the distribution of these materials and the offer and sale of the securities.

United Kingdom. This document is for distribution (i) in the United Kingdom only to persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (the "FSMA") (Financial Promotion) Order 2005 (as amended, the "Financial Promotion Order"), or persons falling within Article 49(2)(a) to (d) ("high net worth companies, unincorporated associations etc.") of the Financial Promotion Order or (ii) persons outside the United Kingdom (all such persons in (i) and (ii) together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons.

European Economic Area. This prospectus supplement has been prepared on the basis that all offers of securities made pursuant to it will be made pursuant to an exemption under the Prospectus Directive, as implemented in member states of the European Economic Area ("EEA"), from the requirement to produce a prospectus for offers of securities. Accordingly any person making or intending to make any offer within the EEA of securities pursuant to this prospectus should only do so in circumstances in which no obligation arises for us or any of the underwriters, dealers or agents to produce a prospectus for that offer. Neither Barclays Bank PLC nor any underwriter, dealer or agent has authorized, nor do they authorize, the making of any offer of securities in circumstances in which an obligation arises for Barclays Bank PLC or any underwriter, dealer or agent to publish a prospectus for that offer.

SUMMARY

The Barclays Bank Group

Barclays Bank PLC and its subsidiary undertakings (taken together, the "Group") is a transatlantic consumer, corporate and investment bank offering products and services across personal, corporate and investment banking, credit cards and wealth and management, with a strong presence in our two home markets of the United Kingdom and the United States. Following the strategy update described in our Current Report on Form 6-K filed with the U.S. Securities and Exchange Commission (the "SEC") on March 1, 2016 (Film No. 161472067), the Group will be focused on two core divisions: Barclays UK and Barclays Corporate & International. Barclays UK is composed of the U.K. retail banking operations, U.K. consumer credit card business, U.K. wealth management business and corporate banking for smaller businesses. Barclays Corporate & International is composed of the corporate banking franchise, the Investment Bank, the U.S. and international cards business and international wealth management. Assets that do not fit the Group's strategic objective will continue to be managed in Barclays Non-Core and designated for exit or run-down over time. The whole of the issued ordinary share capital of Barclays Bank PLC is beneficially owned by Barclays PLC, which is the ultimate holding company of the Group.

The registered head office of Barclays Bank PLC is located at 1 Churchill Place, London, E14 5HP, England. Our telephone number is 011-44-20-7116-1000.

In this prospectus supplement, unless the context otherwise requires, "we," "us" and "our" mean Barclays Bank PLC, and references to "$" are to U.S. dollars.

Overview of the Securities

This section summarizes the material terms that will apply generally to the securities issued as part of a series. Each particular security will have financial and other terms specific to it. Some of those terms as pertaining to the notes are described under the captions "Terms of the Notes," "Interest Mechanics" and "Reference Assets," and certain of those terms as pertaining to the warrants are described under the captions "Terms of the Warrants" and "Reference Assets." The specific terms of each security issuance will be described in a pricing supplement that will accompany this prospectus supplement and the prospectus. Those terms may vary from the terms described here. As you read this prospectus supplement, please remember that the specific terms of your security as described in your

pricing supplement will supplement and, if applicable, may modify or replace the general terms described in this section and in the accompanying prospectus. Unless we say otherwise below, the terms we use in this prospectus supplement that we also use in the accompanying prospectus have the meanings we give them in the prospectus. Similarly, the terms we use in any pricing supplement that we also use in this prospectus supplement will have the meanings we give them in this prospectus supplement, unless we say otherwise in the pricing supplement.

Types of Securities

The principal, interest or any other amounts payable on or any other property deliverable in respect of the notes, and the amount of money or warrant property payable or deliverable in respect of the warrants, may be based on, as applicable, one or more of the following or on movements in the level(s), value(s) or price(s) of, or other events relating to, one or more of the following: equity securities, shares or other interests in exchange-traded funds, exchange-traded notes, commodities, currencies, interest rates, indices of any of the foregoing or any combination thereof, indices of consumer prices or other asset classes. In addition, any amounts payable or property deliverable on the securities, may be based on measures, formulas or instruments, including those related to macroeconomic events or indicators or the occurrence or nonoccurrence of any event or circumstance, or baskets composed of any instruments or measures, as specified in the applicable pricing supplement. We refer to each of the assets, instruments or measures on which payments on the securities may be based as a "reference asset."

See "Terms of the Notes," "Terms of the Warrants" and "Reference Assets" in this prospectus supplement.

Under no circumstances will we offer or issue warrants for the purchase or sale of our ordinary shares or the ordinary shares of Barclays PLC.

Ranking

The securities constitute our direct, unconditional, unsecured and unsubordinated obligations ranking *pari passu*, without any preference among themselves, with all our other outstanding unsecured and unsubordinated obligations, present and future, except those obligations as are preferred by operation of law.

The securities are not deposit liabilities of Barclays Bank PLC and are not covered by the U.K. Financial Services Compensation Scheme or insured by the U.S. Federal Deposit Insurance Corporation ("FDIC") or any other governmental agency or deposit insurance agency of the United States, the United Kingdom or any other jurisdiction.

Agreement with Respect to the Exercise of U.K. Bail-in Power

Notwithstanding any other agreements, arrangements or understandings between Barclays Bank PLC and any holder of the securities, by acquiring the securities, each holder of the securities acknowledges, accepts, agrees to be bound by, and consents to the exercise of, any U.K. Bail-in Power (as defined below) by the relevant U.K. resolution authority (as defined below) that may result in (i) the reduction or cancellation of all, or a portion, of the principal amount of, interest on, or any other amounts payable on, the securities; (ii) the conversion of all, or a portion, of the principal amount of, interest on, or any other amounts payable on, the securities into shares or other securities or other obligations of Barclays Bank PLC or another person (and the issue to, or conferral on, the holder of the securities such shares, securities or obligations); and/or (iii) the amendment or alteration of the maturity of the securities, or amendment of the amount of interest or any other amounts due on the securities, or the dates on which interest or any other amounts become payable, including by suspending payment for a temporary period; which U.K. Bail-in Power may be exercised by means of a variation of the terms of the securities solely to give effect to the exercise by the relevant U.K. resolution authority of such U.K. Bail-in Power. Each holder of the securities further acknowledges and agrees that the rights of the holders of the securities are subject to, and will be varied, if necessary, solely to give effect to, the exercise of any U.K. Bail-in Power by the relevant U.K. resolution authority. For the avoidance of doubt, this consent and acknowledgment is not a waiver of any rights holders of the securities may have at law if and to the extent that any U.K. Bail-in Power is exercised by the relevant U.K. resolution authority in breach of laws applicable in England.

For these purposes, a "U.K. Bail-in Power" is any write-down, conversion, transfer, modification and/or suspension power existing from time to time under any laws, regulations, rules or requirements relating to the resolution of banks, banking group companies, credit institutions and/or investment firms incorporated in the United Kingdom in effect and applicable in the United Kingdom to Barclays Bank PLC or other members of the Group (as defined below), including but not limited to any such laws, regulations, rules or requirements that are implemented, adopted or enacted within the context of any applicable European Union directive or regulation of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and/or within the context of a U.K. resolution regime under the Banking Act, pursuant to which obligations of a bank, banking group company, credit institution or investment firm or any of its affiliates can be reduced, cancelled, amended, transferred and/or converted into shares or other securities or obligations of the obligor or any other person (and a reference to the "relevant U.K. resolution authority" is to any authority with the ability to exercise a U.K. Bail-in Power). See "U.K. Bail-in Power" and "Risk Factors—Risks Relating to the Securities Generally—Regulatory action in the event a bank or investment firm in the Group is failing or likely to fail could materially adversely affect the value of the securities" and "—Under the terms of the securities, you have agreed to be bound by the exercise of any U.K. Bail-in Power by the relevant U.K. resolution authority" in this prospectus supplement.

Medium-Term Notes

The notes described in this prospectus supplement are a separate series of our debt securities. We summarize various terms that apply generally to our debt securities, including the notes described in this prospectus supplement, in the accompanying prospectus under the caption "Description of Debt Securities." The following description of the notes supplements that description of the debt securities. Consequently, you should read this prospectus supplement together with the accompanying prospectus and the relevant pricing supplement in order to understand the terms of the notes.

The Notes Will Be Issued Under the Senior Debt Indenture

The notes are governed by the senior debt indenture between us and The Bank of New York Mellon, which acts as trustee. The trustee has two main roles:

- First, the trustee can enforce your rights against us if we default. There are limitations on the extent to which the trustee acts on your behalf, which we describe under "Description of Debt Securities" in the accompanying prospectus; and

- Second, the trustee performs administrative duties for us, such as sending you any interest and principal payments and notices.

The indenture and the notes are governed by the laws of the State of New York.

We May Issue Other Series of Debt Securities

The senior debt indenture permits us to issue different series of debt securities from time to time. The medium-term notes are a single, distinct series of debt securities. We may, however, issue notes in any amounts, at any times and on any terms as we wish. The notes may differ from other notes issued pursuant to the series designated as our Global Medium-Term Notes, Series A, and from debt securities of other series, in their terms. When we refer to "the notes," "the medium-term notes" or "these notes," we mean our Global Medium-Term Notes, Series A. When we refer to a "series" of debt securities, we mean a series, such as the notes, issued under the senior debt indenture. When we refer to a "class" of the medium-term notes, we mean notes of a certain offering that may be reopened or reissued as described under "Summary—Medium-Term Notes—Amounts That We May Issue" and "Summary—Medium-Term Notes—Reissuances or Reopened Issues," resulting in notes with different issue dates, but otherwise the same terms.

Amounts That We May Issue

The senior debt indenture does not limit the aggregate amount of debt securities that we may issue. Nor does it limit the number of series or the aggregate principal amount of any particular series that we may issue. We intend to issue notes initially in an amount having the aggregate offering price specified on the cover of the applicable pricing supplement. However, we may issue additional notes in amounts that exceed the amount on the cover of the applicable pricing supplement at any time, without your consent and without notifying you. Our affiliates, including Barclays Capital Inc., may use this prospectus supplement to resell notes in market-making transactions from time to time. We describe these transactions under "Plan of Distribution" below. The senior debt indenture and the notes do not limit our ability to incur other indebtedness or to issue other securities. Also, we are not subject to financial or similar restrictions by the terms of the notes or the senior debt indenture, except as described under "Description of Debt Securities" in the accompanying prospectus.

Reissuances or Reopened Issues

Under some limited circumstances, and at our sole discretion, we may "reopen" or reissue certain issuances of notes, without your consent and without notifying you. These further issuances, if any, will be consolidated to form a single class with the originally issued notes and will have the same CUSIP number and will trade interchangeably with the notes immediately upon settlement, *provided* that if the further issuances are not fungible with the originally issued notes for U.S. federal income tax purposes, the further issuances will have a separate CUSIP number. Any additional issuances will increase the aggregate principal amount of the outstanding notes of the class, plus the aggregate principal amount of any notes bearing the same CUSIP number that are issued pursuant to (1) any over-allotment option we may grant to an agent and (2) any future issuances of notes bearing the same CUSIP number. The price of any additional offering will be determined at the time of pricing of that offering.

We are under no obligation to reopen or reissue any notes, and we have no obligation to take your interests into account when deciding whether to reopen or reissue any notes.

This Section Is Only a Summary

The senior debt indenture and its associated documents, including your note, contain the full legal text of the matters described in this section and your pricing supplement. The senior debt indenture and the notes are governed by New York law. A copy of the senior debt indenture has been filed with the SEC as part of our registration statement. See "Further Information" in the accompanying prospectus for information on how to obtain a copy. Investors should carefully read the description of the terms and provisions of our senior debt securities and the senior debt indenture under "Description of Debt Securities" in the accompanying prospectus. That section, together with this prospectus supplement and the relevant pricing supplement, summarize material terms of the senior debt indenture and your note. They do not, however, describe every aspect of the senior debt indenture and your note. For example, in the section entitled "Terms of the Notes" in this prospectus supplement, the accompanying prospectus and your pricing supplement, we use terms that have been given special meaning in the senior debt indenture, but we describe the meaning of only the more important of those terms.

Form, Denomination and Legal Ownership of Notes

Unless otherwise specified in the applicable pricing supplement, your note will be issued:

- in registered form, without interest coupons;
- in authorized denominations of $1,000 (or the specified currency equivalent) and integral multiples thereof; and
- in book-entry form, represented by a global note or a master global note.

You should read the section "Description of Debt Securities—Legal Ownership; Form of Debt Securities" in the accompanying prospectus for information about this type of arrangement and your rights under this type of arrangement.

Universal Warrants

The warrants described in this prospectus supplement are a separate series of our warrants. We summarize various terms that apply generally to our warrants, including the warrants described in this prospectus supplement, in the accompanying prospectus under the caption "Description of Warrants." The following description of the universal warrants supplements that description of the warrants. Consequently, you should read this prospectus supplement together with the accompanying prospectus and the relevant pricing supplement in order to understand the terms of the universal warrants.

The Warrants Will Be Issued Under a Warrant Indenture or Warrant Agreement

The warrants are governed either by the warrant indenture between us and The Bank of New York Mellon, which acts as trustee, or a warrant agreement between us and the applicable warrant agent.

The trustee acting pursuant to the warrant indenture has two main roles:

- First, the trustee can enforce your rights against us if we default. There are limitations on the extent to which the trustee acts on your behalf, which we describe under "Description of Warrants" in the accompanying prospectus; and
- Second, the trustee performs administrative duties for us, such as sending you payments and notices or transferring warrant property, as applicable.

The warrant indenture and the warrants are governed by the laws of the State of New York.

The warrant agent acting pursuant to a warrant agreement will act as agent in connection with the warrants issued under that agreement.

We May Issue Other Series of Warrants

The warrant indenture or warrant agreement, as applicable, permits us to issue different series of warrants from time to time. We may issue warrants in any quantities, at any times and on any terms as we wish. The warrants may differ from one another, and from warrants of other series, in their terms. When we refer to "the warrants," "universal warrants" or "these warrants," we mean our universal warrants. When we refer to a "series" of warrants, we mean all warrants issued as part of the same series under the applicable warrant indenture or warrant agreement. When we refer to a "class" of the warrants, we mean warrants of a certain offering that may be reopened or reissued as described under "Summary—Universal Warrants—Amounts That We May Issue" and "Summary—Universal Warrants—Reissuances or Reopened Issues," resulting in warrants with different issue dates, but otherwise the same terms.

Amounts That We May Issue

Neither the warrant indenture nor the warrant agreement limits the aggregate number of warrants that we may issue. Nor does the warrant indenture or the warrant agreement limit the number of series or the aggregate number of any particular series that we may issue. We intend to issue universal warrants initially in the aggregate number specified on the cover of the applicable pricing supplement. However, we may issue additional universal warrants in numbers that exceed the amount on the cover of the applicable pricing supplement at any time, without your consent and without notifying you. Our affiliates, including Barclays Capital Inc., may use this prospectus supplement to resell warrants in market-making transactions from time to time. We describe these transactions under "Plan of Distribution" below. The warrant indenture, warrant agreement and the warrants do not limit our ability to incur indebtedness or to issue other securities. Also, we are not subject to financial or similar restrictions by the terms of the warrants, the warrant indenture or warrant agreement, except as described under "Description of Warrants" in the accompanying prospectus.

Reissuances or Reopened Issues

Under some limited circumstances, and at our sole discretion, we may "reopen" or reissue certain issuances of warrants, without your consent and without notifying you. These further issuances, if any, will be consolidated to form a single class with the originally issued warrants and will have the same CUSIP number and will trade interchangeably with the warrants immediately upon settlement, *provided* that if the further issuances are not fungible with the originally issued warrants for U.S. federal income tax purposes, the further issuances will have a separate CUSIP number. Any additional issuances will increase the aggregate number of the outstanding warrants of the class, plus the aggregate number of any warrants bearing the same CUSIP number that are issued pursuant to (1) any over-allotment option we may grant to an agent and (2) any future issuances of warrants bearing the same CUSIP number. The price of any additional offering will be determined at the time of pricing of that offering.

We are under no obligation to reopen or reissue any warrants, and we have no obligation to take your interests into account when deciding whether to reopen or reissue any warrants.

This Section Is Only a Summary

The warrant indenture or warrant agreement, as applicable, and their respective associated documents, including your warrant, contain the full legal text of the matters described in this section and your pricing supplement. The warrant indenture or warrant agreement, as applicable, and the warrant, are governed by New York law. Copies of the form of warrant indenture and the form of warrant agreement have been filed with the SEC as part of our registration statement. The specific warrant agreement under which we issue any warrants will be filed with the SEC either as an exhibit to an amendment to the registration statement or as an exhibit to a current report on Form 6-K. See "Further Information" in the accompanying prospectus for information on how to obtain a copy of the warrant indenture or warrant agreement. Investors should carefully read the description of the terms and provisions of our warrants and the warrant indenture or the warrant agreement, as applicable, under "Description of Warrants" in the accompanying prospectus. That section, together with this prospectus supplement and the relevant pricing supplement, summarize material terms of the warrant indenture or warrant agreement, as applicable, and your warrant. They do not, however, describe every aspect of the warrant indenture or warrant agreement and your warrant. For example, in the section entitled "Terms of the Warrants" herein, the accompanying prospectus and your pricing supplement, we use terms that have been given special meaning in the warrant indenture or warrant agreement, but we describe the meaning of only the more important of those terms.

Form, Denomination and Legal Ownership of Warrants

Unless otherwise specified in the applicable pricing supplement, your warrant will be issued:

- in registered form;
- in authorized denominations of 100 and integral multiples thereof; and
- in book-entry form, represented by a global warrant or a master global warrant.

You should read the section "Description of Warrants—Legal Ownership; Form of Warrants" in the accompanying prospectus for information about this type of arrangement and your rights under this type of arrangement.

Conflicts of Interest

Barclays Capital Inc. is an affiliate of Barclays Bank PLC and, as such, will have a "conflict of interest" in any offering in which it participates, as either principal or agent, within the meaning of Rule 5121 of Financial Industry Regulatory Authority, Inc. ("FINRA") (or any successor rule thereto) ("Rule 5121"). Consequently, any such offering will be conducted in compliance with the provisions of Rule 5121. Barclays Capital Inc. is not permitted to sell securities in any such offering to an account over which it exercises discretionary authority without the prior specific written approval of the account holder.

RISK FACTORS

You should understand the risks of investing in the securities and should reach an investment decision only after careful consideration with your advisors of the suitability of the securities in light of your particular financial circumstances, the following risk factors and the other information included or incorporated by reference in the applicable pricing supplement, any applicable product supplement, any applicable index supplement, this prospectus supplement and the prospectus. Please note that this "Risk Factors" section has various subsections addressing risk factors relating to specific types of reference assets and transaction structures. We have no control over a number of matters, including economic, financial, regulatory, geographic, judicial and political events, that are important in determining the existence, magnitude and longevity of these risks and their influence on the value of, or the payments made on or settlement of obligations with respect to, the securities. You should not purchase the securities unless you understand and can bear these investment risks.

Risks Relating to the Securities Generally

(1) The notes differ from conventional debt securities and may not pay interest or return all of your principal amount.

Any amounts payable on the notes will be determined pursuant to the terms set forth in the relevant pricing supplement. The notes will not pay interest unless specified in the relevant pricing supplement, and any interest payments may be contingent on the performance of the reference asset(s). The relevant pricing supplement may specify that you may lose some or all of your principal amount at maturity. Even if the relevant pricing supplement provides for payment of at least your principal amount at maturity (subject to the credit risks of Barclays Bank PLC and to the exercise of any U.K. Bail-in Power by U.K. resolution authorities), you may receive no return on your investment at maturity or the return on your investment at maturity may be less than the amount that would be paid on a conventional debt security of ours of comparable maturity. Under these circumstances, you will not be compensated or fully compensated for any loss in value due to inflation and other factors relating to the value of money over time.

(2) The warrants are subject to significant risks and may expire worthless.

You will receive a cash payment or warrant property upon exercise (including automatic exercise, if applicable) only if the warrant has a settlement value greater than zero at that time. You should therefore be prepared to lose all or some of your investment in the warrants you purchase. The warrants are not standardized options issued by the Options Clearing Corporation. See "Risk Factors—Additional Risks Relating to Warrants" below.

(3) The securities are subject to the credit risk of Barclays Bank PLC, and are not insured against loss by any third parties.

The securities are the direct, unconditional, unsecured and unsubordinated obligations of Barclays Bank PLC, and are not, either directly or indirectly, an obligation of any third party. Any payment to be made on the securities is subject to the ability of Barclays Bank PLC to satisfy its obligations as they come due and to the exercise of any U.K. Bail-in Power by the relevant U.K. resolution authority, as described below. As a result, the actual and perceived creditworthiness of Barclays Bank PLC may affect the market value of the securities and, in the event Barclays Bank PLC were to default on its obligations, you might not receive any amounts owed to you under the terms of the securities. If Barclays Bank PLC is unable to satisfy its obligations with respect to the securities, the market value of your securities will be negatively impacted. See also "Risk Factors—Risks Relating to All Securities—The securities are not insured by the FDIC" in this prospectus supplement.

(4) Regulatory action in the event a bank or investment firm in the Group is failing or likely to fail could materially adversely affect the value of the securities.

The European Union directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms of May 15, 2014, as amended (the "BRRD"), provides an EU-wide framework for the recovery and resolution of credit institutions and investment firms, their subsidiaries and certain holding companies. The BRRD (including the bail-in tool), together with the majority of associated Financial Conduct Authority ("FCA") and PRA (as defined under "U.K. Bail-In Power—Certain Definitions" in this prospectus supplement) rules, was implemented in the U.K. in January 2015. The final

PRA rules on contractual recognition of bail-in for liabilities came into force on January 1, 2016. The majority of the requirements of the BRRD (including the bail-in tool) were implemented by way of amendments to the Banking Act. For more information on the bail-in tool, see "*The relevant U.K. resolution authority may exercise the bail-in tool in respect of Barclays Bank PLC and the securities, which may result in holders of the securities losing some or all of their investment*" and "—Under the terms of the securities, you have agreed to be bound by the exercise of any U.K. Bail-in Power by the relevant U.K. resolution authority" below.

The Banking Act confers substantial powers on a number of U.K. authorities designed to enable them to take a range of actions in relation to U.K. banks or investment firms and certain of their affiliates in the event a bank or investment firm in the same group is considered to be failing or likely to fail. The exercise of any of these actions in relation to Barclays Bank PLC or any Group subsidiary could materially adversely affect the value of the securities.

Under the Banking Act, substantial powers are granted to the Bank of England (or, in certain circumstances, HM Treasury), in consultation with the PRA, the FCA and HM Treasury, as appropriate, as part of a special resolution regime (the "SRR"). These powers enable the relevant U.K. resolution authority to implement resolution measures with respect to a U.K. bank or investment firm and certain of its affiliates that meet the definition of a "banking group company" (currently including Barclays Bank PLC) (each, a "relevant entity") in circumstances in which the relevant U.K. resolution authority is satisfied that the resolution conditions are met. Such conditions include that a U.K. bank or investment firm is failing or is likely to fail to satisfy the Financial Services and Markets Act 2000 (the "FSMA") threshold conditions for authorization to carry on certain regulated activities (within the meaning of section 55B FSMA) or, in the case of a U.K. banking group company that is an EEA or third country institution or investment firm, that the relevant EEA or third country relevant authority is satisfied that the resolution conditions are met in respect of such entity.

The SRR consists of five stabilization options: (a) private sector transfer of all or part of the business or shares of the relevant entity, (b) transfer of all or part of the business of the relevant entity to a "bridge bank" established by the Bank of England, (c) transfer to an asset management vehicle wholly or partly owned by HM Treasury or the Bank of England, (d) the bail-in tool (as described below) and (e) temporary public ownership (nationalization).

The Banking Act also provides for two new insolvency and administration procedures for relevant entities. Certain ancillary powers include the power to modify contractual arrangements in certain circumstances (which could include a variation of the terms of the securities), powers to suspend enforcement or termination rights that might be invoked as a result of the exercise of the resolution powers and powers for the relevant U.K. resolution authority to disapply or modify laws in the U.K. (with possible retrospective effect) to enable the powers under the Banking Act to be used effectively.

Holders of the securities should assume that, in a resolution situation, financial public support will only be available to a relevant entity as a last resort after the relevant U.K. resolution authorities have assessed and used, to the maximum extent practicable, the resolution tools, including the bail-in tool.

The exercise of any resolution power or any suggestion of any such exercise could materially adversely affect the value of the securities and could lead to holders losing some or all of the value of their investment in the securities.

The SRR is designed to be triggered prior to insolvency of Barclays Bank PLC, and holders of the securities may not be able to anticipate the exercise of any resolution power (including the U.K. Bail-in Power) by the relevant U.K. resolution authority.

The stabilization options are intended to be used prior to the point at which any insolvency proceedings with respect to the relevant entity could have been initiated. The purpose of the stabilization options is to address the situation where all or part of a business of a relevant entity has encountered, or is likely to encounter, financial difficulties, giving rise to wider public interest concerns.

Although the Banking Act provides specific conditions to the exercise of any resolution powers and, furthermore, European Banking Authority's guidelines published in May 2015 set out the objective elements for the resolution authorities to apply in determining whether an institution is failing or likely to fail, it is uncertain how the relevant U.K. resolution authority would assess such conditions in any particular pre-insolvency scenario affecting Barclays Bank PLC and/or other members of the Group and in deciding whether to exercise a resolution power.

The relevant U.K. resolution authority is also not required to provide any advance notice to holders of the securities of its decision to exercise any resolution power. Therefore, holders of the securities may not be able to anticipate a potential exercise of any such powers nor the potential effect of any exercise of such powers on Barclays Bank PLC, the Group and the securities.

Holders of the securities may have only very limited rights to challenge the exercise of any resolution powers (including the U.K. Bail-in Power) by the relevant U.K. resolution authority.

Holders of the securities may have only very limited rights to challenge and/or seek a suspension of any decision of the relevant U.K. resolution authority to exercise its resolution powers (including the U.K. Bail-in Power) or to have that decision reviewed by a judicial or administrative process or otherwise.

The relevant U.K. resolution authority may exercise the bail-in tool in respect of Barclays Bank PLC and the securities, which may result in holders of the securities losing some or all of their investment.

Where the relevant statutory conditions for use of the bail-in tool have been met, the relevant U.K. resolution authority would be expected to exercise these powers without the consent of the holders. Any such exercise of the bail-in tool in respect of Barclays Bank PLC and the securities may result in the cancellation of all, or a portion, of the principal amount of, interest on, or any other amounts payable on, the securities and/or the conversion of the securities into shares or other securities or other obligations of Barclays Bank PLC or another person, or any other modification or variation of the terms of the securities.

The Banking Act specifies the order in which the bail-in tool should be applied, reflecting the hierarchy of capital instruments under CRD IV (as defined under "U.K. Bail-In Power—Certain Definitions" in this prospectus supplement) and otherwise respecting the hierarchy of claims in an ordinary insolvency. In addition, the bail-in tool contains an express safeguard (known as "no creditor worse off") with the aim that shareholders and creditors do not receive a less favorable treatment than they would have received in ordinary insolvency proceedings involving the relevant entity.

The exercise of the bail-in tool in respect of Barclays Bank PLC and the securities or any suggestion of any such exercise could materially adversely affect the rights of the holders, the price or value of their investment in the securities and/or the ability of Barclays Bank PLC to satisfy its obligations under the securities and could lead to holders losing some or all of the value of their investment in the securities.

(5) Under the terms of the securities, you have agreed to be bound by the exercise of any U.K. Bail-in Power by the relevant U.K. resolution authority.

Notwithstanding any other agreements, arrangements or understandings between us and any holder of the securities, by acquiring the securities, each holder of the securities acknowledges, accepts, agrees to be bound by, and consents to the exercise of, any U.K. Bail-in Power by the relevant U.K. resolution authority that may result in (i) the reduction or cancellation of all, or a portion, of the principal amount of, interest on, or any other amounts payable on, the securities; (ii) the conversion of all, or a portion, of the principal amount of, interest on, or any other amounts payable on, the securities into shares or other securities or other obligations of Barclays Bank PLC or another person (and the issue to, or conferral on, the holder of the securities such shares, securities or obligations); and/or (iii) the amendment or alteration of the maturity of the securities, or amendment of the amount of interest or any other amounts due on the securities, or the dates on which interest or any other amounts become payable, including by suspending payment for a temporary period; which U.K. Bail-in Power may be exercised by means of a variation of the terms of the securities solely to give effect to the exercise by the relevant U.K. resolution authority of such U.K. Bail-in Power. Each holder of the securities further acknowledges and agrees that the rights of the holders of the securities are subject to, and will be varied, if necessary, solely to give effect to, the exercise of any U.K. Bail-in Power by the relevant U.K. resolution authority.

Accordingly, any U.K. Bail-in Power may be exercised in such a manner as to result in you and other holders of the securities losing all or a part of the value of your investment in the securities or receiving a different security from the securities, which may be worth significantly less than the securities and which may have significantly fewer protections than those typically afforded to debt securities. Moreover, the relevant U.K. resolution authority may exercise the U.K. Bail-in Power without providing any advance notice to, or requiring the consent of, the holders of the securities. In addition, under the terms of the securities, the exercise of the U.K. Bail-in Power by the

relevant U.K. resolution authority with respect to the securities is not an event of default under the relevant indenture.

For more information, see "U.K. Bail-in Power" in this prospectus supplement. See also "Risk Factors—Regulatory action in the event a bank or investment firm in the Group is failing or likely to fail could materially adversely affect the value of the securities" in this prospectus supplement.

(6) If the securities are not listed on a national securities exchange, the securities are intended to be held to maturity or to the relevant exercise date or period, as applicable.

If the securities are not listed on a national securities exchange, you may receive less, and possibly significantly less, than the amount you originally invested if you sell your securities prior to maturity or prior to the relevant exercise date or period, as applicable. Unless otherwise specified in the relevant pricing supplement, you should be willing to hold your securities to maturity or to the relevant exercise date or period.

(7) There may not be any secondary market for your securities.

Upon issuance, the securities will not have an established trading market. We cannot assure you that a trading market for the securities will develop or, if one develops, that it will be maintained. Although we may apply to list certain issuances of securities on a national securities exchange, we may not meet the requirements for listing and do not expect to announce, prior to the issuance of the securities, whether we will meet those requirements. Even if there is a secondary market, it may not provide liquidity. While we anticipate that our affiliate, Barclays Capital Inc., may make a market for the securities, it is not required to do so. If the securities are not listed on any securities exchange and Barclays Capital Inc. were to cease acting as a market maker, which it may do at any time for any reason, it is likely that there would be no secondary market for the securities. Therefore, you must be willing and able to hold the securities until maturity or until the relevant exercise date or period, as applicable.

(8) The estimated value of your securities is expected to be lower than the initial issue price of your securities.

The estimated value of your securities on the initial valuation date is expected to be lower, and may be significantly lower, than the initial issue price of your securities. The difference between the initial issue price of your securities and the estimated value of the securities is expected as a result of certain factors, such as any sales commissions expected to be paid to Barclays Capital Inc. or another affiliate of ours, any selling concessions, discounts, commissions or fees expected to be allowed or paid to non-affiliated intermediaries, the estimated profit that we or any of our affiliates expect to earn in connection with structuring the securities, the estimated cost that we may incur in hedging our obligations under the securities, and estimated development and other costs that we may incur in connection with the securities. Moreover, at our sole option, we may decide to sell additional securities after the initial valuation date. Our estimated value of the securities on any subsequent trade date or pricing date may reflect issue prices, commissions and aggregate proceeds that differ from the amounts set forth in the applicable pricing supplement and will take into account a number of variables, including prevailing market conditions and our subjective assumptions, which may or may not materialize, on the date that those additional securities are traded or priced for sale to the public. As a result of changes in these variables, our estimated value of the securities on any subsequent trade date or pricing date may differ significantly from our estimated value of the securities on the initial valuation date.

(9) The estimated value of the securities is based on our internal pricing models, which may prove to be inaccurate and may be different from the pricing models of other financial institutions.

The estimated value of your securities on the initial valuation date is based on our internal pricing models, which take into account a number of variables and are based on a number of subjective assumptions, which may or may not materialize. These variables and assumptions are not evaluated or verified on an independent basis. Further, our pricing models may be different from other financial institutions' pricing models and the methodologies used by us to estimate the value of the securities may not be consistent with those of other financial institutions that may be purchasers or sellers of securities in the secondary market. As a result, the secondary market price of your securities may be materially different from the estimated value of the securities determined by reference to our internal pricing models.

(10) The estimated value of your securities is not a prediction of the prices at which you may sell your securities in the secondary market, if any, and the secondary market prices, if any, will likely be lower than the initial issue price of your securities and may be lower than the estimated value of your securities.

The estimated value of the securities will not be a prediction of the prices at which Barclays Capital Inc., other affiliates of ours or third parties may be willing to purchase the securities from you in secondary market transactions (if they are willing to purchase, which they are not obligated to do). The price at which you may be able to sell your securities in the secondary market at any time will be influenced by many factors that cannot be predicted, such as market conditions, and any bid and ask spread for similar sized trades, and may be substantially less than our estimated value of the securities. Further, as secondary market prices of your securities (i) in the case of notes, take into account the levels at which our debt securities trade in the secondary market, and (ii) in all cases, do not take into account our various costs related to the securities such as fees, commissions, discounts, and the costs of hedging our obligations under the securities, secondary market prices of your securities will likely be lower than the initial issue price of your securities. As a result, the price at which Barclays Capital Inc., other affiliates of ours or third parties may be willing to purchase the securities from you in secondary market transactions, if any, will likely be lower than the price you paid for your securities, and any sale prior to the maturity date could result in a substantial loss to you.

(11) The temporary price at which we may initially buy the securities in the secondary market and the value we may initially use for customer account statements, if we provide any customer account statements at all, may not be indicative of future prices of your securities.

Assuming that all relevant factors remain constant after the initial valuation date, the price at which Barclays Capital Inc. may initially buy or sell the securities in the secondary market (if Barclays Capital Inc. makes a market in the securities, which it is not obligated to do) and the value that we may initially use for customer account statements, if we provide any customer account statements at all, may exceed our estimated value of the securities on the initial valuation date, as well as the secondary market value of the securities, for a temporary period after the initial offering date of the securities. The price at which Barclays Capital Inc. may initially buy or sell the securities in the secondary market and the value that we may initially use for customer account statements may not be indicative of future prices of your securities.

(12) Price or other movements in a reference asset and its components are unpredictable.

Movements in the level, value or price of a reference asset or its components are unpredictable and volatile, and are influenced by complex and interrelated political, economic, financial, regulatory, geographic, judicial and other factors. Moreover, the global capital, credit and commodity markets have experienced volatility and disruption in the last several years. In periods of high volatility, the markets may produce downward pressure on the level, value or price of a reference asset.

It is impossible to predict whether the level, value or price of a reference asset will rise or fall during the term of the securities. Changes in the level, value or price of a reference asset will affect any amounts payable or property deliverable on the securities. Therefore, these changes may result in a significant loss on your securities. There can be no assurance that the levels of volatility and periods of sudden and dramatic price increases or declines seen over the last several years will not continue or recur.

As the securities are linked to reference asset(s) that may be unpredictable and volatile, there can be no assurance that these changes will not be adverse to you, and therefore, you may not receive any return and may suffer a significant loss on your securities.

(13) The historical or hypothetical historical performance of a reference asset is not an indication of its future performance.

The historical or hypothetical historical performance of a reference asset, which may be included in the applicable pricing supplement, should not be taken as an indication of the future performance of that reference asset. It is impossible to predict whether the level, value or price of a reference asset will fall or rise during the term of the securities, in particular in the environment in the last several years, which has been characterized by volatility across a wide range of asset classes. Past fluctuations and trends in the reference asset(s)—either individually or in comparison to each other in the case of securities linked to a basket or to the best or worst performing reference asset in a group of reference assets—are not necessarily indicative of fluctuations or trends that may occur in the future.

(14) You must rely on your own evaluation of the merits of an investment in the securities.

In connection with your purchase of the securities, we urge you to consult your own financial, tax and legal advisors as to the risks involved in an investment in the securities and to investigate the reference asset(s) and not rely on our views in any respect. You should make a complete investigation as to the merits of an investment in the securities.

(15) The price at which you will be able to sell your securities prior to the maturity date or prior to the relevant exercise date or period, as applicable, will depend on a number of factors and may be substantially less than the amount you had originally invested.

If you wish to liquidate your investment in the securities prior to the maturity date or prior to the relevant exercise date or period, as applicable, your only alternative, in the absence of any applicable provisions for redemption at the option of the holder, would be to sell them. However, there may be an illiquid market for the securities or no market at all. Even if you were able to sell your securities, there are many factors that may affect their market value. We believe that the market value of your securities will be affected by the volatility of the reference asset(s), the level(s), value(s) or price(s) of the reference asset(s) at the time of the sale, changes in interest rates, our actual and perceived financial condition and credit ratings, the supply of and demand for the securities, the time remaining until the maturity or until the relevant exercise date or period, as applicable, of the securities and a number of other factors. Some of these factors are interrelated in complex ways; as a result, the effect of any one factor may be offset or magnified by the effect of another factor. The price, if any, at which you will be able to sell your securities prior to maturity or prior to the relevant exercise date or period, as applicable, may be substantially less than the amount you originally invested and will depend on the market value of the securities at the time of the sale. The following paragraphs describe the manner in which we expect the market value of the securities to be affected in the event of a change in a specific factor, assuming all other conditions remain constant.

- *Reference asset performance*. We expect that the market value of the securities prior to maturity or prior to the relevant exercise date or period, as applicable, will depend substantially on the then-current level(s), values(s) or price(s) (or in some cases, performance since the date on which the securities price) of the reference asset(s) relative to their initial level(s), value(s) or price(s). If you decide to sell your securities prior to maturity or prior to the relevant exercise date or period, as applicable, when the level(s), value(s) or prices(s) of the reference asset(s) at the time of sale are favorable relative to their initial level(s), value(s) or price(s), you may nonetheless receive substantially less than the amount that would be payable at maturity or upon exercise if those level(s), value(s) or price(s) were to have been determined at valuation dates later in the term of the securities because of expectations at the earlier time of sale that the level(s), value(s) or price(s) will continue to fluctuate until the final level(s), value(s) or price(s) are determined.

- *Volatility of a reference asset*. Volatility is the term used to describe the degree of variation in the level, value or price of a reference asset over a period of time. If the volatility of a reference asset or its components increases or decreases, the market value of the securities may be adversely affected.

- *Interest rates*. We expect that the market value of the securities will be affected by changes in interest rates. Interest rates also may affect the economy and, in turn, the level(s), value(s) or price(s) of the reference asset or their components, which would affect the market value of the securities.

- *Supply and Demand for the Securities*. We expect that the market value of the securities will be affected by the supply of and demand for the securities. In general, if the supply of the securities increases and/or the demand for the securities decreases, the market value of the securities may be adversely affected. The supply of the securities, and therefore the market value of the securities, may be affected by inventory positions held by us or our affiliates or any market maker.

- *Exercise or Redemption Rights and Call Rights*. Your right to redeem the notes, if any, or our right to call the notes or the warrants, if any, as applicable, may affect the market value of the relevant securities. Generally, the lack of a redemption right for note holders and the inclusion of a call right by us may each adversely affect the market value of the securities.

- *Our financial condition, credit ratings and results of operations*. Actual or anticipated changes in our financial condition, credit ratings or results of operations may significantly affect the market value of the securities. The significant difficulties experienced in the global financial system in the last several years and resulting lack of credit, lack of confidence in the financial sector, increased volatility in the financial markets and reduced business activity could materially and adversely affect our business, financial condition, credit ratings and results of operations. However, because the return on the securities is dependent upon factors in addition to our ability to pay or settle our obligations under the securities (such as the current level(s), value(s) or price(s) of the reference asset(s)), you should not expect an improvement in our financial condition, credit ratings or results of operations to have a positive effect on the market value of the securities. These credit ratings relate only to our creditworthiness, do not affect or enhance the return on the securities and are not indicative of other risks associated with the securities or an investment in the reference asset(s). A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, change or withdrawal at any time by the assigning rating agency.

- *Time remaining to maturity or to the expiration date*. A "time premium" results from expectations concerning the level(s), value(s) or price(s) of the reference asset(s) during the period prior to the maturity date of the notes or prior to the expiration date of the warrants. As the time remaining to the maturity date of the notes or to the expiration date of the warrants decreases, this time premium will likely decrease, potentially adversely affecting the market value of the securities. As the time remaining to maturity or to the expiration date, as applicable, decreases, the market value of the securities may be less sensitive to any favorable changes in the volatility of the reference asset(s).

- *Events affecting or involving a reference asset*. Economic, financial, regulatory, geographic, judicial, political and other developments that affect the level, value or price of a reference asset and its components, and real or anticipated changes in those factors, also may affect the market value of the securities. For example, if a reference asset is composed of equity securities, the financial condition and earnings results of a component of that reference asset, and real or anticipated changes in those conditions or results, may affect the market value of the securities. In addition, speculative trading by third parties in a reference asset could significantly increase or decrease the level, value or price of that reference asset, thereby exposing that reference asset to additional volatility, which could adversely affect the market value of the securities.

- *Agent's commission and cost of hedging*. The initial issue price of the securities includes the agent's commission or discount, if any, and may reflect the estimated cost of hedging our obligations under the securities. These costs may include our or our affiliates' expected cost of providing that hedge and the profit we expect to realize in consideration for assuming the risks inherent in providing that hedge. As a result, assuming no change in market conditions or any other relevant factors, the price, if any, at which we (or our affiliates) will be willing to purchase securities from you in secondary market transactions, if at all, will likely be lower than the initial issue price, and could result in a substantial loss to you. In addition, any secondary market prices may differ from values determined by pricing models used by us or our affiliates, as a result of dealer discounts, mark-ups or other transaction costs. Moreover, this hedging activity may result in us or our affiliates realizing a profit, even if the market value of the securities declines.

The effect of any one factor may be offset or magnified by the effect of another factor.

(16) The securities are not insured against loss by any third parties.

The securities will be solely our obligations, and no other entity will have any payment or settlement obligations, contingent or otherwise, in respect of the securities. In the event that we are unable to pay or settle our obligations under the securities, you risk losing your entire investment.

(17) The securities are not insured by the FDIC.

The securities are not deposit liabilities of Barclays Bank PLC and neither the securities nor your investment in the securities are insured by the FDIC or any other governmental agency or deposit insurance agency of the United States, United Kingdom or any other jurisdiction. In the event that we are unable to pay or settle our obligations under the securities, you risk losing your entire investment.

(18) There are no security interests in the securities or other financial instruments or assets held by Barclays Bank PLC.

Neither the indenture governing the notes nor the warrant indenture or warrant agreement, as applicable, governing the warrants contains any restrictions on our ability or the ability of any of our affiliates to sell, pledge or otherwise convey all or any portion of the securities or other instruments or assets acquired by us or our affiliates. Neither we nor any of our affiliates will pledge or otherwise hold those securities or other instruments or assets for the benefit of holders of the securities. Consequently, in the event of a bankruptcy, insolvency or liquidation involving us, any of those securities or other instruments or assets that we own will be subject to the claims of our creditors generally and will not be available specifically for the benefit of the holders of the securities. Any amounts payable or property deliverable on the securities constitute our unsecured and unsubordinated obligations ranking *pari passu*, without any preference among themselves, with all our other outstanding unsecured and unsubordinated obligations, present and future, except those obligations as are preferred by operation of law.

(19) A downgrade of the rating assigned by any credit rating agency to Barclays Bank PLC or to the securities could adversely affect the liquidity or market value of the securities. Ratings downgrades could occur as a result of, among other causes, changes in the ratings methodologies used by credit rating agencies. Changes in credit rating agencies' views of the level of implicit sovereign support for European banks and their groups are likely to lead to ratings downgrades.

Certain securities may be rated by credit rating agencies, although Barclays Bank PLC is under no obligation to ensure that the securities are rated by any credit rating agency. Credit ratings may not reflect the potential impact of all risks related to structure, market, additional factors discussed in this "Risk Factors" section and other factors that may affect the liquidity or market value of the securities. A credit rating is not a recommendation to buy, sell or hold securities and may be revised, suspended or withdrawn by the credit rating agency at any time.

Any rating assigned to Barclays Bank PLC or the securities may be withdrawn entirely by a credit rating agency, may be suspended or may be lowered, if, in that credit rating agency's judgment, circumstances relating to the basis of the rating so warrant. Ratings may be impacted by a number of factors which can change over time, including the credit rating agency's assessment of: the issuer's strategy and management's capability; the issuer's financial condition including in respect of capital, funding and liquidity; competitive and economic conditions in the issuer's key markets; the level of political support for the industries in which the issuer operates; and legal and regulatory frameworks affecting the issuer's legal structure, business activities and the rights of its creditors. The credit rating agencies may also revise the ratings methodologies applicable to issuers within a particular industry, or political or economic region. If credit rating agencies perceive there to be adverse changes in the factors affecting an issuer's credit rating, including by virtue of changes to applicable ratings methodologies, the credit rating agencies may downgrade, suspend or withdraw the ratings assigned to an issuer and/or its securities.

In particular, Moody's Investors Service Ltd., Standard & Poor's Credit Market Services Europe Limited and Fitch Ratings Limited each published revised methodologies applicable to bank ratings (including Barclays Bank PLC) during 2015 which resulted in credit rating actions being taken on the Barclays Bank PLC's ratings, including downgrading of certain ratings. Further revisions to ratings methodologies and actions on Barclays Bank PLC's ratings by the credit rating agencies may occur in the future.

If Barclays Bank PLC determines to no longer maintain one or more ratings, or if any credit rating agency withdraws, suspends or downgrades the credit ratings of Barclays Bank PLC or the securities, or if such a withdrawal, suspension or downgrade is anticipated (or any credit rating agency places the credit ratings of Barclays Bank PLC or any securities on "credit watch" status in contemplation of a downgrade, suspension or withdrawal), whether as a result of the factors described above or otherwise, such event could adversely affect the liquidity or market value of the securities (whether or not the securities had an assigned rating prior to such event).

(20) A reference asset or its components may trade outside regular trading hours in the United States; however, if any secondary market for the securities develops, the securities may trade only during regular trading hours in the United States.

If the market for a reference asset or its components is an international market, the hours of trading for the securities, if any, may not conform to the hours during which that reference asset or its components are traded. To the extent that U.S. markets are closed while international markets remain open, significant movements may take place in the level, value or price of a reference asset or its components that will not be reflected immediately in the price of the securities. There may not be any systematic reporting of last-sale or similar information for a reference asset or its components. The absence of last-sale or similar information and the limited availability of quotations would make it difficult for many investors to obtain timely, accurate data about the state of the market for a reference asset or its components.

(21) The calculation agent may postpone the determination of any amounts payable or property deliverable on the securities if a market disruption event occurs.

A valuation date (as described under "Terms of the Notes—Valuation Dates, Review Dates, Determination Dates, Observation Dates and Averaging Dates" and "Terms of the Warrants—Valuation Dates, Review Dates, Determination Dates, Observation Dates and Averaging Dates" below) for the securities may be postponed if the calculation agent determines that a market disruption event with respect to a reference asset has occurred or is continuing on that valuation date or if the calculation agent determines that a valuation date is not a scheduled trading day with respect to the reference asset (each as described under "Reference Assets" below). If the securities are linked to a basket of multiple assets or to the highest or lowest return in a group of two or more reference assets, the valuation date(s) may be postponed with respect to one or more basket components or reference assets (as described under "Reference Assets—Baskets" and "Reference Assets—Least or Best Performing Reference Asset"). You will not be entitled to compensation from us or the calculation agent for any loss suffered as a result of the postponement of any valuation date, any resulting delay in payment or any change in the level, value or price of the affected reference asset after the originally scheduled valuation date.

As a result of the foregoing, payment dates for the securities (including, in the case of notes, the maturity date) may be postponed, as described under "Terms of the Notes—Payment Dates" or "Terms of the Warrants—Payment Dates" below, as applicable. If a payment date is postponed, we will not be obligated to pay or deliver, and you may not receive, any amounts payable or property deliverable on the relevant payment date until several days after the originally scheduled payment date. Any payment or delivery made under the circumstances will not result in a default under any security or the applicable indenture or warrant agreement.

(22) The U.S. federal income tax consequences of an investment in certain securities are uncertain.

There is no direct legal authority regarding the proper U.S. federal income tax treatment of certain securities (including, in particular, securities that are not treated as indebtedness for U.S. federal income tax purposes) and we do not plan to request a ruling from the Internal Revenue Service (the "IRS"). Consequently, significant aspects of the tax treatment of certain securities are uncertain, and the IRS or a court might not agree with the treatment of the securities as described in the applicable section under "Material U.S. Federal Income Tax Consequences" in this prospectus supplement. If the IRS were successful in asserting an alternative treatment, the tax consequences of your ownership and disposition of the securities could be materially and adversely affected. In addition, in 2007 the U.S. Treasury Department and the IRS released a notice requesting comments on various issues regarding the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. Any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in certain securities, possibly with retroactive effect.

You should review the discussion under "Material U.S. Federal Income Tax Consequences" below and consult your tax adviser regarding the U.S. federal tax consequences of an investment in the securities, as well as tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

(23) We or one of our affiliates could serve as the calculation agent, which could result in a conflict of interest.

The calculation agent will make determinations and judgments in connection with valuing the reference asset(s) and calculating adjustments to the reference asset(s), dates, level(s), value(s) or price(s) or any other affected variable when the reference asset(s) are changed or modified as well as determining whether a market disruption event has occurred. You should refer to "Terms of the Notes—Calculations and Calculation Agent" and "Terms of the Warrants—Calculations and Calculation Agent" below. Because we or one of our affiliates could serve as the calculation agent, a conflict of interest may arise in connection with the calculation agent performing its role as calculation agent. In making any discretionary judgments, the fact that the calculation agent is our affiliate may cause it to have economic interests that are adverse to yours as an investor in the securities. While the calculation agent is obligated to carry out its duties and functions as calculation agent in good faith and using reasonable judgment, the calculation agent will have no obligation to consider your interests as an investor in the securities in making any determinations with respect to the securities.

(24) You will be bound by the determinations made by the calculation agent.

The calculation agent will, in its sole discretion, make certain determinations in respect of your securities that may include determinations regarding relevant dates and amounts payable or property deliverable in respect of your securities. Absent manifest error, all determinations of the calculation agent will be final and binding on you and us, without any liability on the part of the calculation agent. You will not be entitled to any compensation from us for any loss suffered as a result of any determinations made by the calculation agent with respect to the securities.

(25) Trading and other transactions by us or our affiliates could affect the level, value or price of a reference asset and its components, the market value of the securities and any amounts payable or property deliverable on your securities.

In connection with our normal business practices or in connection with hedging our obligations under the securities, we and our affiliates may from time to time buy or sell a reference asset and its components, or similar instruments, or derivative instruments relating to that reference asset or its components. These trading activities may present a conflict of interest between your interest in the securities and the interests we and our affiliates may have in our proprietary accounts, in facilitating transactions, including block trades, for our other customers and in accounts under our management. These trading activities also could affect the level, value or price of a reference asset in a manner that would decrease the market value of the securities and any amounts payable or property deliverable on the securities. To the extent that we or any of our affiliates have a hedge position in a reference asset or its components, or in a derivative or synthetic instrument related to a reference asset or its components, we or any of our affiliates may increase or liquidate a portion of those holdings at any time before, during or after the term of the securities. This activity may affect any amounts payable or property deliverable on your securities or the market value of the securities in a manner that would be adverse to your investment in the securities. Depending on, among other things, future market conditions, the aggregate amount and the composition of those hedge positions are likely to vary over time. In addition, we or any of our affiliates may purchase or otherwise acquire a long or short position in the securities. We or any of our affiliates may hold or resell any such position in the securities.

(26) The securities may be subject to an investor fee and other costs.

The securities may be subject to an investor fee and other costs as specified in the applicable pricing supplement. Because the investor fee and any applicable costs reduce the amount of your return, the value of the relevant reference asset must increase significantly (or, for securities that provide short exposure to the reference asset, decrease significantly) in order for you to receive, in the case of notes, at least the principal amount of your investment at maturity or upon redemption, or for you to receive any return on your investment in the warrants. If the value of the reference asset decreases or does not increase sufficiently (or, for securities that provide short exposure to the reference asset, increases or does not decrease sufficiently) to offset the investor fee and any applicable costs, you may receive less than the principal amount of your investment at maturity or upon redemption, in the case of notes, or you may receive little or no return on your investment in the warrants.

(27) Research reports and other transactions may create conflicts of interest between you and us.

We or one or more of our affiliates may have published, and may in the future publish, research reports relating to a reference asset or any of its components. The views expressed in this research may be modified from time to time without notice and may express opinions or provide recommendations that are inconsistent with purchasing or

holding the securities. Any of these activities may affect the level, value or price of a reference asset or its components and, therefore, the market value of the securities and any amounts payable or property deliverable on your securities. Moreover, other professionals who deal in these markets may at any time have views that differ significantly from ours. In connection with your purchase of the securities, you should investigate the reference asset(s) and their components and not rely on our views with respect to future movements in the reference asset(s) and their components.

We or any of our affiliates also may issue, underwrite or assist unaffiliated entities in the issuance or underwriting of other securities or financial instruments with returns linked to the reference asset(s) or their components. By introducing competing products into the marketplace in this manner, we or our affiliates could adversely affect the market value of the securities.

We and our affiliates, at present or in the future, may engage in business relating to the persons or organizations responsible for calculating, publishing or maintaining any reference asset that is an index or exchange-traded fund, which we refer to as the "sponsor" of that reference asset. In addition, we or our affiliates may engage in business relating to any reference asset or its components, including making loans to, equity investments in, or providing investment banking, asset management or other advisory services to the issuer of equity securities that are a reference asset or a component of a reference asset. In connection with these activities, we may receive information pertinent to the reference assets or their components that we will not divulge to you.

(28) We cannot control actions by a sponsor or issuer of any reference asset or its components.

Actions by the sponsor of any index or exchange-traded fund that is a reference asset or by the issuer of any equity security that is a reference asset or a component of a reference asset may have an adverse effect on the level, value or price of that reference asset and therefore on the market value of the securities. Unless otherwise specified in the applicable pricing supplement, no sponsor or issuer of a reference asset or its components will be involved with the administration, marketing or trading of the securities and no sponsor or issuer of a reference asset or its components will have any obligations with respect to any amounts payable or property deliverable on the securities, or to consider your interests as a holder of the securities when it takes any actions that might affect the market value of the securities. No sponsor or issuer of a reference asset or its components will receive any of the proceeds of any security offering and no sponsor or issuer of a reference asset or its components will be responsible for, or have participated in, the determination of the timing of, prices for, or quantities of, the securities to be issued.

Unless otherwise specified in the applicable pricing supplement, we will not be affiliated with any sponsor or issuer of a reference asset or its components (except for the licensing arrangements with respect to indices, if any, discussed in any applicable index supplement or the applicable pricing supplement), and we have no ability to control or predict their actions. These actions could include mergers or tender offers in the case of reference assets consisting of securities or errors in information disclosed by a sponsor of an index or an issuer of an equity security or any discontinuance by that sponsor or issuer of that disclosure.

However, we or any of our affiliates may currently, or in the future, engage in business with any sponsor of an index or exchange-traded fund or issuer of an equity security. In addition, the value of one or more reference assets may be determined in whole or in part by reference to the value of a benchmark that is established based on quotes, prices, values or other data provided by market participants, including, in some cases, us or our affiliates. We and our affiliates will have no obligation to consider your interests as a holder of the securities in taking any actions that might affect the value of any reference asset or the securities.

Neither we, nor any of our affiliates, including the agent, assume any responsibility for the adequacy or accuracy of any publicly available information about the sponsor or issuer of any reference asset or its components. You should make your own investigation into the reference asset(s) and the sponsor(s) or issuer(s) of the reference asset(s) or their components.

(29) No research recommendation on your securities.

Although we or one or more of our affiliates may publish research on, or assign a research recommendation to, other financial products linked to the performance of a reference asset or its components or a sponsor or issuer of a reference asset, neither we nor any of our subsidiaries or affiliates publishes research on, or assigns a research recommendation to, your securities.

(30) You have no recourse to the sponsor or issuer of any reference asset or any of its components.

Your investment in the securities will not give you any rights against the sponsor or issuer of any reference asset or any of its components, including any sponsor (with respect to an index or exchange-traded fund) that may determine or publish the level, value or price of a reference asset and any issuer (with respect to equity securities) that may otherwise affect the level, value or price of a reference asset.

(31) Any indices that are reference assets or tracked by reference assets that are exchange-traded funds may be discontinued; the manner in which these indices are calculated may change in the future; and instruments composing these indices, or their respective weights, may change.

There can be no assurances that any indices that are reference assets or tracked by reference assets that are exchange-traded funds will continue or the method by which these indices are calculated will remain unchanged. The sponsors of these indices may have the ability from time to time to change the method by which these indices are calculated or to take emergency action under their rules, which could adversely affect the level, value or price of a reference asset and any amounts payable or property deliverable on your securities and the market value of your securities. In addition, if a reference asset that is an index is discontinued or altered, the calculation agent may select a substitute index to calculate any amounts payable or property deliverable on your securities. This substitution may adversely affect the market value of the securities.

Further, the sponsors of these indices can add, delete or substitute the components of these indices or make other methodological changes that could adversely change the values of the reference assets and, therefore, the market value of the securities. You should realize that changes in the components of these indices may affect the reference assets, as a newly added instrument or instruments may perform significantly worse than the instrument or instruments it replaces. We have no control over the way these indices are calculated by the sponsors.

In the case of a reference asset that is an exchange-traded fund, if a discontinuance or suspension of the index tracked by that exchange-traded fund occurs, following a termination of that exchange-traded fund, the calculation agent may substitute a successor fund that is comparable to that discontinued exchange-traded fund, or if the calculation agent determines that no successor fund is available, accelerate the maturity date of the notes or the exercise date or exercise period of the warrants. If the securities are accelerated, holders of the securities will not benefit from any potential appreciation of the exchange-traded fund from the accelerated maturity date to the originally scheduled maturity date. Any of these actions may adversely affect the market value of the securities, as well as any amounts payable or property deliverable on the securities.

(32) Changes in laws or regulations may affect the market value of the securities and any amounts payable or property deliverable on your securities

The level, value or price of a reference asset could be adversely affected by the promulgation of new laws or regulations or by the reinterpretation of existing laws or regulations after the date hereof (including, without limitation, those relating to taxes and duties on any reference asset) by one or more governments, governmental agencies or instrumentalities, courts or other official bodies. For example, direct or indirect government intervention may restrict the issuance or trading of products, such as your securities, linked to the value of international securities (or indices relating to those securities). Governments may also seek to regulate not only the reference asset(s) to which your securities are linked but also derivative instruments based on a reference asset, which can affect the value of that reference asset. Any of these events could adversely affect the level, value or price of a reference asset and, correspondingly, could adversely affect the market value of the securities, as well as any amounts payable or property deliverable on the securities.

(33) Any discontinuance or suspension of calculation or publication of the level, value or price of a reference asset may adversely affect the market value of the securities and any amounts payable or property deliverable on the securities.

If the calculation or publication of the level, value or price of a reference asset is discontinued or suspended, and the discontinuance or suspension is continuing on a valuation date, it may become difficult for the calculation agent to determine accurately the level, value or price of that reference asset for that valuation date and any amounts payable or property deliverable on the securities. If the discontinuance or suspension is continuing on the final valuation date (as described under "Terms of the Securities—Valuation Dates, Review Dates, Determination Dates, Observation Dates and Averaging Dates" and "Terms of the Warrants—Valuation Dates, Review Dates, Determination Dates, Observation Dates and Averaging Dates" below), it may become difficult for the calculation

agent to determine accurately the amounts of any payments payable or property deliverable on the securities. In these situations, the calculation agent will follow a substitute procedure to determine the most appropriate payment or settlement value as described in this prospectus supplement (for example, as described under "Reference Assets—Exchange-Traded Funds—Adjustments Relating to Securities with an Exchange-Traded Fund as a Reference Asset—Discontinuance of the Exchange-Traded Fund") or in the applicable pricing supplement. Any of these events may have a material adverse effect on the market value of the securities and any amounts payable or property deliverable on the securities.

(34) We may sell additional notes at a different issue price.

At our sole option, we may decide to sell an additional amount of the notes offered by any pricing supplement subsequent to the date of that pricing supplement but prior to the original issue date. The issue price of the notes in the subsequent sale may differ substantially (higher or lower) from the initial issue price you paid as provided in the applicable pricing supplement.

(35) If you purchase your notes at a premium to the principal amount, the return on your investment will be lower than the return on notes purchased at the principal amount and the impact of certain key terms of the notes will be negatively affected.

Any amounts payable on the notes will not be adjusted based on the price you pay for the notes. If you purchase notes at a price that differs from the principal amount of the notes, then the return on your investment in those notes held to the maturity date will differ from, and may be substantially less than, the return on notes purchased at the principal amount. If you purchase your notes at a premium to the principal amount and hold them to the maturity date, the return on your investment in the notes will be lower than it would have been had you purchased the notes at the principal amount or a discount to the principal amount. In addition, the impact of certain terms of the notes on the return on your investment will depend upon the price you pay for your notes relative to the principal amount.

(36) The amounts payable or property deliverable on your securities is not based on the level(s), value(s) or price(s) of the reference asset(s) at any time other than the specified valuation date or dates.

The level(s), value(s) or price(s) of the reference asset(s) may be based on the level(s), value(s) or price(s) of those reference asset(s) on the specified valuation date or dates (subject to adjustments as described in this prospectus supplement). Therefore, if the level, value or price of one or more reference assets drops precipitously on the valuation date or dates, the amounts payable or property deliverable on your securities may be significantly less than it would otherwise have been had the payment been linked to the level(s), value(s) or price(s) of the reference asset(s) prior to such drop(s).

Additional Risks Relating to Securities with Reference Assets That Are Equity Securities, Indices of Equity Securities or Exchange-Traded Funds that Hold Equity Securities

The use of the term "reference asset(s)" under this subsection may refer to an equity security, an index composed of equity securities or an exchange-traded fund that includes equity securities.

(37) The market value of the securities and any amounts payable or property deliverable on the securities will be affected by equity market risks.

We expect that the reference asset(s) will generally fluctuate in accordance with changes in the financial condition of the issuer(s) of the reference asset(s) for reference assets that are equity securities or the equity securities that are components of reference asset(s) that are indices or exchange-traded funds, the value of equity securities generally and other factors. The financial condition of the issuer(s) of the equity securities may become impaired or the general condition of the equity market may deteriorate, either of which may cause a decrease in the level(s), value(s) or price(s) of the reference asset(s) and thus in the market value of the securities and any amounts payable or property deliverable on the securities. Equity securities are susceptible to general equity market fluctuations, to speculative trading by third parties and to volatile increases and decreases in value as market confidence in and perceptions regarding those equity securities change. Investor perceptions regarding the issuer of an equity security are based on various and unpredictable factors, including expectations regarding government, economic, monetary and fiscal policies, inflation and interest rates, economic expansion or contraction, and global or regional political, economic and banking crises.

(38) You have no rights in the property, or shareholder rights in any securities of any issuer, of a reference asset or the equity securities composing or held by a reference asset.

Investing in the securities will not make you a holder of any reference asset or the equity securities composing or held by any reference asset. Neither you nor any other holder or owner of the securities will have any voting rights, any right to receive dividends or other distributions, or any other rights with respect to any property or securities of any issuer or with respect to any equity securities underlying or held by a reference asset.

(39) Payments on the securities will not reflect dividends or other distributions on any of the reference assets or the equity securities composing or held by the reference assets.

Unless specified in the applicable pricing supplement, any amounts payable or property deliverable on the securities will not reflect the payment of dividends or other distributions on any of the reference assets or the equity securities held by or underlying the reference assets. Therefore, the yield derived from an investment in the securities will not be the same as if you had purchased any of the reference assets or those equity securities and held them for a similar period.

(40) We will obtain the information about the sponsors or issuers of the reference assets or the equity securities underlying or held by the reference assets from publicly available information.

We will derive all information in any applicable index supplement and the applicable pricing supplement about the reference assets or their issuers from publicly available documents or other publicly available information, without independent verification. We have not participated, and will not participate, in the preparation of any of those documents, nor have we made, or will we make, any "due diligence" investigation or any inquiry with respect to the reference assets or their issuers in connection with the offering of the securities. Furthermore, we do not and will not know whether all events occurring before the date of any applicable index supplement and the applicable pricing supplement, including events that would affect the accuracy or completeness of the publicly available documents referred to above or the level(s), value(s) or price(s) of the reference asset(s), have been publicly disclosed. Subsequent disclosure of any events of this kind or the disclosure of, or failure to disclose, material future events concerning the sponsors or issuers could adversely affect any amounts payable or property deliverable on the securities and the market value of the securities.

(41) The issuer of an equity security may perform actions that could adversely affect the market value of the securities.

For a reference asset that is an equity security, the calculation agent may adjust any variable described in the applicable pricing supplement, including but not limited to any date, price (including but not limited to the initial price, any price derived from the initial price, the final price or the closing price or other relevant value on any valuation date), any combination thereof or any other variable for share splits, mergers, tender offers, reverse stock splits, stock dividends, extraordinary dividends and other events that affect the capital structure of the issuer of the applicable equity securities, as well as for certain actions taken by a depositary for American depositary shares that affect the reference asset in the situations and in the manner described under "Reference Assets—Equity Securities—Share Adjustments Relating to Securities with an Equity Security as a Reference Asset" in this prospectus supplement or in the applicable pricing supplement. The calculation agent may make similar adjustments to any variable described in the applicable pricing supplement in the case of a reference asset that is an exchange-traded fund as described under "Reference Assets—Exchange-Traded Funds—Adjustments Relating to Securities with an Exchange-Traded Fund as a Reference Asset" in this prospectus supplement or in the applicable pricing supplement. However, the calculation agent is not required to make an adjustment for every event that may affect the equity securities or exchange-traded funds. Any of the above events or other actions by the issuer of an equity security or an exchange-traded fund that is a reference asset or by a third party may adversely affect the market value of the reference asset and, therefore, adversely affect the market value of the securities and any amounts payable or property deliverable on the securities.

(42) For securities linked to indices of non-U.S. equity securities, if the prices of the non-U.S. equity securities are converted into U.S. dollars for purposes of calculating the level of the applicable index, the securities will be subject to currency exchange risk.

If the securities are linked to indices of non-U.S. equity securities and the prices of the non-U.S. equity securities are converted into U.S. dollars for purposes of calculating the level of the applicable index, then investors in those securities will be exposed to the currency exchange rate risk with respect to each of the currencies in which the non-U.S. equity securities underlying that index trade. Exchange rate movements for a particular currency can often be volatile and are the result of numerous factors including the supply of, and the demand for, those currencies, as well as the relevant government policy, intervention or actions, but are also influenced significantly from time to time by political or economic developments, and by macroeconomic factors and speculative actions related to the relevant region. An investor's net exposure will depend on the extent to which the currencies of the non-U.S. equity securities underlying the applicable index strengthen or weaken against the U.S. dollar and the relative weight of the non-U.S. equity securities denominated in those currencies. If, taking into account that weighting, the dollar strengthens against the currencies of the securities underlying the applicable index, the level of that index will be adversely affected and any amounts payable or property deliverable on the securities may be reduced.

Of particular importance to potential currency exchange risk are: existing and expected rates of inflation; existing and expected interest rate levels; the balance of payments in the relevant countries and the United States and between each relevant country and its major trading partners; the extent of governmental surplus or deficit in the relevant countries and the United States; and intervention by the relevant countries or the United States in currency exchange rates, including through the imposition of currency controls. All of these factors are, in turn, sensitive to the monetary, fiscal and trade policies pursued by the relevant countries, the United States and those of other countries important to international trade and finance.

(43) For securities linked to indices of non-U.S. equity securities, if the prices of those non-U.S. equity securities are not converted into U.S. dollars for purposes of calculating the level of the applicable index, any amounts payable or property deliverable on the securities will not be adjusted for fluctuations in exchange rates.

If the securities are linked to indices of non-U.S. equity securities and the prices of the non-U.S. equity securities are not converted into U.S. dollars for purposes of calculating the level of the applicable index, then the value of the securities will not be adjusted for exchange rate fluctuations between the U.S. dollar and the currencies in which the non-U.S. equity securities underlying the applicable index are denominated, although any currency fluctuations could affect the performance of that index. If any applicable currency appreciates relative to the U.S. dollar over the term of the securities, investors will not receive the benefit of that increase, which they would have had they owned the non-U.S. equity securities underlying the relevant index directly.

(44) Securities linked to exchange-traded funds holding non-U.S. equity securities will be subject to currency exchange risk.

Because the price of an exchange-traded fund that holds non-U.S. equity securities is related to the U.S. dollar value of the non-U.S. equity securities, investors in these securities will be exposed to the currency exchange rate risk with respect to each of the currencies in which the non-U.S. equity securities held by that exchange-traded fund trade. Currency exchange rates may be subject to a high degree of fluctuation, as described above under "Risk Factors—For securities linked to indices of non-U.S. equity securities, if the prices of the non-U.S. equity securities are converted into U.S. dollars for purposes of calculating the level of the applicable index, the securities will be subject to currency exchange risk." An investor's net exposure will depend on the extent to which the currencies of the non-U.S. equity securities held by the applicable exchange-traded fund strengthen or weaken against the U.S. dollar and the relative weight of the non-U.S. equity securities denominated in those currencies. If, taking into account that weighting, the dollar strengthens against the currencies of the securities held by the applicable exchange-traded fund, the value of that exchange-traded fund's portfolio will be adversely affected, which is expected to have an adverse effect on the price per share of the exchange-traded fund, and any amounts payable or property deliverable on the securities may be reduced.

(45) Time differences between the domestic and international markets may create discrepancies in the market value of the securities if the reference assets or the equity securities composing or held by those reference assets trade wholly or partly on international markets.

In the event that the reference assets or the equity securities held by the reference assets trade wholly or partly on an international market, time differences between the domestic and international markets (e.g., New York City is 13 or 14 hours (depending on time of year) behind Tokyo) may result in discrepancies between the values of the reference assets or the equity securities held by the reference assets. To the extent that U.S. markets are closed while markets for the reference assets or the equity securities composing or held by the reference assets remain open, significant price or rate movements may take place in the reference assets or the equity securities composing or held by the reference assets that will not be reflected immediately in the market value of the securities. In addition, there may be periods when the relevant international markets are closed for trading (e.g., during holidays in an international country), causing the values of the reference assets or the equity securities composing or held by the reference assets to remain unchanged for multiple trading days in New York City.

(46) Securities linked to non-U.S. equity securities and/or indices of non-U.S. equity securities and/or exchange-traded funds that include non-U.S. equity securities will be subject to risks associated with non-U.S. securities markets.

Non-U.S. equity securities are issued by non-U.S. companies in non-U.S. securities markets. Investments in securities linked to the value of non-U.S. equity securities or indices or exchange-traded funds that include non-U.S. equity securities involve risks associated with the securities markets in the home countries of the issuers of those non-U.S. equity securities. Non-U.S. securities markets may have less liquidity and may be more volatile than U.S. securities markets, and market developments may affect non-U.S. markets differently than U.S. securities markets. Direct or indirect government intervention to stabilize a non-U.S. securities market, as well as cross-shareholdings in non-U.S. companies, may affect trading prices and volumes in those markets. In addition, governments may seek to regulate not only the reference assets or the equity securities composing or held by the reference assets to which your securities are linked but also derivative instruments based on the equity securities, which can affect the value of the equity securities and your securities. Also, there is generally less publicly available information about companies in some of these jurisdictions than there is about U.S. companies that are subject to the reporting requirements of the Securities and Exchange Commission, and generally non-U.S. companies are subject to accounting, auditing and financial reporting standards and requirements and securities trading rules different from those applicable to U.S. reporting companies. The prices of securities in non-U.S. markets may be affected by political, economic, financial and social factors in those countries, or global regions, including changes in government, economic and fiscal policies and currency exchange laws.

Further, non-U.S. equity securities may be issued by companies in countries considered as emerging markets. Emerging markets pose further risks in addition to the risks associated with investing in non-U.S. equity markets generally. Countries considered as emerging markets may have relatively unstable governments, may present the risks of nationalization of businesses, restrictions on foreign ownership and prohibitions on the repatriation of assets, and may have less protection of property rights than more developed countries. The economies of countries considered as emerging markets may be based on only a few industries, may be highly vulnerable to changes in local or global trade conditions, and may suffer from extreme and volatile debt burdens or inflation rates. Local securities markets may trade a small number of securities and may be unable to respond effectively to increases in trading volume, potentially making prompt liquidation of holdings difficult or impossible at times. Moreover, the economies in those countries may differ unfavorably from the economy in the United States in such respects as growth of gross national product, rate of inflation, capital reinvestment, resources, self-sufficiency and balance of payment positions.

Some or all of these factors may adversely affect the performance of the applicable non-U.S. equity securities and, as a result, the market value of the securities and any amounts payable or property deliverable on the securities.

(47) The issuers of the reference assets or the equity securities composing or held by the reference assets could take actions that may adversely affect the securities.

The issuers of the reference assets or the equity securities composing or held by the reference assets will have no involvement in the offer and sale of the securities and no obligation to you, unless otherwise specified in the applicable pricing supplement. Any of these issuers may take action, such as placing itself into bankruptcy or receivership or engaging in a merger or sale of assets, without regard to your interests. Any of these actions could adversely affect the value of the reference assets or the equity securities composing or held by the reference assets and, correspondingly, could adversely affect the market value of the securities and any amounts payable or property deliverable on the securities.

(48) Securities linked to an exchange-traded fund may be subject to liquidity risk.

Although an exchange-traded fund may be listed for trading on a securities exchange, there is no assurance that an active trading market will develop or continue for the shares of the exchange-traded fund or that there will be liquidity in the trading market. These liquidity issues could adversely affect the performance of the exchange-traded fund and, as a result, the market value of the securities and any amounts payable or property deliverable on the securities.

(49) Securities linked to an exchange-traded fund may be subject to management risk.

An exchange-traded fund may be subject to management risk, which is the risk that the exchange-traded fund's investment adviser's investment strategy, the implementation of which is subject to a number of constraints, may not produce the intended results. For example, the exchange-traded fund's investment adviser may have the right to use a portion of the exchange-traded fund's assets to invest in shares of equity securities that are not included in any index tracked by the exchange-traded fund. The exchange-traded fund may also not be actively managed and may be affected by a general decline in market segments relating to any index tracked by the exchange-traded fund. The exchange-traded fund's investment adviser may also invest in securities included in, or representative of, any index tracked by the exchange-traded fund regardless of their investment merits. The exchange-traded fund's investment adviser may also not be obligated to attempt to take defensive positions in declining markets.

(50) An exchange-traded fund and any index tracked by that exchange-traded fund are different and the performance of the exchange-traded fund may not correlate with the performance of that index.

An exchange-traded fund may use a representative sampling strategy to attempt to track the performance of an index. The exchange-traded fund may not hold all or substantially all of the assets included in that index, may hold those assets in different proportions and may hold assets not included in that index. Therefore, while the performance of the exchange-traded fund may be generally linked to the performance of an index, the performance of the exchange-traded fund may be also linked in part to assets not included in that index and may be linked to assets that differ substantially from those that are tracked by that index. For example, while an index may track equity securities, as a result of the exchange-traded fund's holding of assets other than equity securities, your investment may also be linked to the performance of other assets, such as futures contracts, options and swaps, as well as cash and cash equivalents, including shares of money market funds affiliated with the exchange-traded fund's investment adviser.

Imperfect correlation between the exchange-traded fund's portfolio assets and those in the index tracked by the exchange-traded fund, rounding of prices, changes to that index and regulatory requirements may cause tracking error, the divergence of the exchange-traded fund's performance from that of that index.

In addition, the performance of the exchange-traded fund will reflect additional transaction costs and fees that are not included in the calculation of the index tracked by the exchange-traded fund and this may increase the tracking error of the exchange-traded fund. Also, in the case of exchange-traded funds that track an equity securities index, corporate actions with respect to the sample of equity securities (such as mergers and spin-offs) may impact the performance differential between the exchange-traded fund and that index. Finally, because the shares of the exchange-traded fund are traded on a securities exchange and are subject to market supply and investor demand, the market value of one share of the exchange-traded fund may differ from the net asset value per share of the exchange-traded fund.

Thus, the return on your securities may be less than the return on an investment directly in the assets composing the index tracked by the exchange-traded fund or in a fund that invests in those assets.

(51) Securities linked to an exchange-traded fund are subject to the fluctuation of the market value of the exchange-traded fund.

The net asset value of the shares of an exchange-traded fund is generally expected to fluctuate with changes in the market value of the exchange-traded fund's securities holdings. The market prices of the shares of the exchange-traded fund may fluctuate in accordance with changes in net asset value and supply and demand on the applicable stock exchanges. In addition, the market price of one share of an exchange-traded fund may differ from its net asset value per share; shares of an exchange-traded fund may trade at, above or below their net asset value per share.

During periods of market volatility, securities held by an exchange-traded fund may be unavailable in the secondary market, market participants may be unable to calculate accurately the intraday net asset value per share of the exchange-traded fund and the liquidity of the exchange-traded fund may be adversely affected. This kind of market volatility may also disrupt the ability of market participants to create and redeem shares of the exchange-traded fund. Further, market volatility may adversely affect, sometimes materially, the prices at which market participants are willing to buy and sell shares of the exchange-traded fund. As a result, under these circumstances, the market value of the exchange-traded fund may vary substantially from the net asset value per share of the exchange-traded fund.

(52) Securities linked to American depositary shares carry exchange rate risk.

Because American depositary shares are denominated in U.S. dollars but represent non-U.S. equity securities that are denominated in a non-U.S. currency, changes in currency exchange rates may negatively impact the value of the American depositary shares. The value of the non-U.S. currency may be subject to a high degree of fluctuation due to changes in interest rates, the effects of monetary policies issued by the United States, non-U.S. governments, central banks or supranational entities, the imposition of currency controls or other national or global political or economic developments. Therefore, exposure to exchange rate risk may result in reduced returns for securities linked to American depositary shares.

(53) Additional risks relating to securities linked to American depositary shares of a company.

There are important differences between the rights of holders of American depositary shares and the rights of holders of the shares of equity securities underlying the American depositary shares. Each American depositary share is a security evidenced by American depositary receipts that represent a certain number of shares of the issuing company. The American depositary shares are issued pursuant to a deposit agreement, which sets forth the rights and responsibilities of the depositary, the company, and holders of the American depositary shares, which may be different from the rights of holders of the underlying shares. For example, a company may make distributions in respect of the underlying shares that are not passed on to the holders of its American depositary shares. Any differences between the rights of holders of the American depositary shares and the rights of holders of the underlying shares of the company may be significant and may materially and adversely affect the value of the American depositary shares and, as a result, the value of securities that are linked to American depositary shares.

Additional Risks Relating to Securities with Reference Assets That Are Commodities, Indices of Commodities or Exchange-Traded Funds That Hold Commodities

The use of the term "reference asset(s)" under this subsection may refer to commodities, commodity futures contracts, an index composed of commodities or commodity futures contracts and/or an exchange-traded fund that holds commodities or commodity futures contracts.

(54) Prices of commodities are highly volatile and may change unpredictably.

Commodity prices are highly volatile and, in many sectors, have experienced increased volatility in recent periods. Commodity prices are affected by numerous factors, including: changes in supply and demand relationships (whether actual, perceived, anticipated, unanticipated or unrealized); weather; agriculture; trade, fiscal, monetary and exchange control programs; domestic and foreign political and economic events and policies; disease; pestilence; technological developments; changes in interest rates, whether through governmental action or market movements; monetary and other governmental policies, action and inaction; macroeconomic, geopolitical or military events, including political instability in oil-producing countries or other commodity producing countries; and natural or nuclear disasters. Those events tend to affect prices worldwide, regardless of the location of the event. Market expectations about these events and speculative activity also cause prices to fluctuate. These factors may adversely affect the performance of the reference assets or their components and, as a result, the market value of the securities and any amounts payable or property deliverable on the securities. It is possible that lower prices, or increased

volatility, will adversely affect the performance of the reference assets or their components and, as a result, the market value of the securities.

(55) Changes in supply and demand in the market for futures contracts may adversely affect the value of the securities.

Your securities may be linked to the performance of futures contracts on the applicable underlying physical commodities instead of providing actual exposure to physical commodities. Futures contracts are legally binding agreements for the purchase and sale of a commodity at a fixed price for settlement on a future date. Commodity futures contract prices are subject to similar types of pricing volatility patterns as may affect the specific commodities underlying the futures contracts, as well as additional trading volatility factors that may impact futures markets generally. Moreover, changes in the supply and demand for commodities and futures contracts and for the purchase and sale of particular commodities, may lead to differentiated pricing patterns in the market for futures contracts over time. For example, a futures contract scheduled to expire in the first nearby month may experience more severe pricing pressure or greater price volatility than the corresponding futures contract scheduled to expire in the second nearby month, or vice versa. Under these circumstances, and depending on when the specified valuation date occurs, the price of the reference asset may be determined by reference to the futures contract expiring in a less favorable month for pricing purposes. As a result, the value of your securities may be less than would otherwise be the case if the settlement price of the reference asset had been determined by reference to the corresponding futures contract scheduled to expire in a more favorable month for pricing purposes.

(56) The prices of some futures contracts on commodities may be subject to daily price ceilings and floors.

Some exchanges have regulations that limit the amount of fluctuation in futures contract prices that may occur during a single business day. These limits are generally referred to as "daily price fluctuation limits," and the maximum or minimum price of a futures contract on any given day as a result of these limits is referred to as a "limit price." Once the limit price has been reached in a particular futures contract, no trades may be made at a price above or below the limit price, as the case may be or trading may be limited for a set period of time. Limit prices may have the effect of precluding trading in a particular contract or forcing the liquidation of futures contracts at potentially disadvantageous times or prices. These circumstances could adversely affect the prices of the futures contracts on commodities composing the reference asset and, therefore, could adversely affect the market value of the securities and any amounts payable or property deliverable on the securities.

(57) Suspensions or disruptions of market trading in the commodity markets and related futures markets may adversely affect the market value of the securities and any amounts payable or property deliverable on the securities.

The commodity markets and related futures markets are subject to temporary distortions or other disruptions due to various factors, including a lack of liquidity in the markets, the participation of speculators and potential government regulation and intervention. Some exchanges, or the U.S. Commodity Futures Trading Commission, commonly referred to as the "CFTC," could suspend or terminate trading in a particular futures contract or contracts in order to address market emergencies. These circumstances may adversely affect the performance of the reference assets or their components and, as a result, may adversely affect any amounts payable or property deliverable on the securities.

(58) Risks relating to trading of the reference assets and their components on international futures exchanges.

Some international futures exchanges operate in a manner more closely analogous to the over-the-counter physical commodity markets than to the regulated futures markets, and some features of U.S. futures markets are not present. For example, there may not be any daily price limits which would otherwise restrict the extent of daily fluctuations in the prices of the respective contracts. In a declining market, therefore, it is possible that prices would continue to decline without limitation within a trading day or over a period of trading days. This may adversely affect the performance of the reference assets or their components and, as a result, the market value of the securities and any amounts payable or property deliverable on the securities.

(59) Commodity indices may include contracts that are not traded on regulated futures exchanges.

Commodity indices are typically based solely on futures contracts traded on regulated futures exchanges. However, a commodity index may include over-the-counter contracts (such as swaps and forward contracts) traded on trading facilities that are subject to lesser degrees of regulation or, in some cases, no substantive regulation. As a result, trading in these contracts, and the manner in which prices and volumes are reported by the relevant trading facilities, may not be subject to the provisions of, and the protections afforded by, for example, the U.S. Commodity Exchange Act of 1936, as amended, or other applicable statutes and related regulations, that govern trading on regulated U.S. futures exchanges, or similar statutes and regulations that govern trading on regulated U.K. futures exchanges. In addition, many electronic trading facilities have only recently initiated trading and do not have significant trading histories. As a result, the trading of contracts on these facilities, and the inclusion of these contracts in a commodity index, may be subject to certain risks not presented by, for example, U.S. or U.K. exchange-traded futures contracts, including risks related to the liquidity and price histories of the relevant contracts, which may have a material adverse effect on the market value of the securities and any amounts payable or property deliverable on the securities.

(60) You will not have any rights to receive the reference assets or their components.

Investing in the securities will not make you a holder of any commodity or futures contract on any commodity, or any other futures contract relating to the reference assets or their components. Payments due on the securities will be made in U.S. dollars or the specified currency stated in the applicable pricing supplement, and you will have no right to receive delivery of any commodity or futures contract relating to the reference assets or their components.

(61) Your securities may provide exposure only to futures contracts and may not provide direct exposure to physical commodities.

Your securities may be linked to the performance of futures contracts on physical commodities instead of providing actual exposure to physical commodities. Therefore, the securities will reflect a return based, in part, on the performance of futures contracts and do not provide exposure to the spot prices in respect of the applicable commodities. The price of a commodity futures contract reflects the expected value of the commodity upon delivery in the future, whereas the spot price of a commodity reflects the immediate delivery value of the commodity. A variety of factors can lead to a disparity between the expected future price of a commodity and the spot price at a given point in time, such as the cost of storing the commodity for the term of the futures contract, interest charges incurred to finance the purchase of the commodity and expectations concerning supply and demand for the commodity. The price movement of a futures contract is typically correlated with the movements of the spot price of the reference commodity, but the correlation is generally imperfect and price movements in the spot market may not be reflected in the futures market (and vice versa). Accordingly, the securities may underperform a similar investment that reflects the return on the underlying physical commodities.

(62) Your investment in securities linked to commodities, commodity futures contracts or an index of commodities or commodity futures contracts will not entitle you to the regulatory protections of the CFTC or any other regulated futures exchange.

The net proceeds to be received by us from the sale of securities relating to one or more commodities, commodity futures contracts or an index of commodities or commodity futures contracts will not be used to purchase or sell any commodity futures contracts or options on futures contracts for your benefit. An investment in the securities thus does not constitute either an investment in futures contracts, options on futures contracts or in a collective investment vehicle that trades in these futures contracts (*i.e.*, the securities will not constitute a direct or indirect investment by you in the futures contracts), and you will not benefit from the regulatory protections of the CFTC. We are not registered with the CFTC as a futures commission merchant and you will not benefit from the CFTC's or any other regulatory authority's regulatory protections afforded to persons who trade in futures contracts on a regulated futures exchange through a registered futures commission merchant. Unlike an investment in the securities, an investment in a collective investment vehicle that invests in futures contracts on behalf of its participants may be subject to regulation as a commodity pool and its operator may be required to be registered with and regulated by the CFTC as a commodity pool operator, or qualify for an exemption from the registration requirement. Because the securities will not be interests in a commodity pool, the securities will not be regulated by the CFTC as a commodity pool, we will not be registered with the CFTC as a commodity pool operator, and you will not benefit from the CFTC's or any other regulatory authority's regulatory protections afforded to persons who invest in regulated commodity pools.

(63) Changes in law or regulation relating to commodity futures contracts may adversely affect the market value of certain securities and any amounts payable or property deliverable on your securities.

The commodity futures contracts to which some securities are linked are subject to legal and regulatory regimes that are in the process of changing in the United States and, in some cases, in other countries. Because the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") regulatory scheme (including the rulemaking authority granted to the CFTC) thereunder has not yet been fully implemented, the ultimate impact of the regulations on the markets and market participants cannot yet be determined. Similarly, other regulatory organizations (such as the European Securities and Markets Authority) have proposed, and in the future may propose, further reforms similar to those enacted by the Dodd-Frank Act or other legislation which could have an adverse impact on the liquidity and depth of the commodities, futures and derivatives markets. Any of these changes in laws or regulations may have a material adverse effect on the market value of the securities and any amounts payable or property deliverable on the securities.

(64) The level, value or price of a reference asset or its components can fluctuate widely due to supply and demand disruptions in major producing or consuming regions.

The level, value or price of a reference asset or its components can fluctuate widely due to supply and demand disruptions in major producing or consuming regions. For example, some commodities are used primarily in one industry, and fluctuations in levels of activity in (or the availability of alternative resources to) one industry may have a disproportionate effect on global demand for a particular commodity. Moreover, recent growth in industrial production and gross domestic product has made many developing countries, particularly China, disproportionately large users of commodities and has increased the extent to which the reference assets rely on the markets of these developing countries. Political, economic and other developments that affect these developing countries may affect the level, value or price of a reference asset or its components and, thus, the market value of the securities and any amounts payable or property deliverable on the securities. Because the reference assets may be produced in a limited number of countries and may be controlled by a small number of producers, political, economic and supply-related events in those countries could have a disproportionate impact on the levels of those reference assets or the prices of their components.

(65) Future prices of commodity futures contracts within a commodity index that are different relative to their current prices may affect the value of that commodity index and result in a reduced amount payable or property deliverable on the securities.

Commodity indices typically track commodity future contracts rather than physical commodities. Unlike equities, which typically entitle the holder to a continuing stake in a corporation, commodity futures contracts normally specify a certain date for delivery of the underlying physical commodity. As the exchange-traded futures contracts that compose a commodity index approach expiration, they are replaced by similar contracts that have a later expiration. For example, a futures contract purchased and held in August may specify an October expiration date. As time passes, the contract expiring in October may be replaced by a contract for delivery in December. This process is referred to as "rolling."

If the market for these contracts is (putting aside other considerations) in "backwardation," which means that the prices are lower in the distant delivery months than in the nearer delivery months, the purchase of the December contract would take place at a price that is lower than the sale price of the October contract. Conversely, if the market for these contracts is in "contango," which means that the prices are higher in the distant delivery months than in the nearer delivery months, the purchase of the December contract would take place at a price that is higher than the sale price of the October contract. The difference between the prices of the two contracts when they are rolled is sometimes referred to as a "roll yield."

The presence of contango in the commodity markets could result in negative roll yields, which could adversely affect the value of the commodity index. Because of the potential effects of negative roll yields, it is possible for the value of the commodity index to decrease significantly over time even when the near-term or spot prices of the underlying commodities are stable or increasing. It is also possible, when near-term or spot prices of the underlying commodities are decreasing, for the value of the commodity index to decrease significantly over time even when some or all of the constituent commodity futures contracts are experiencing backwardation.

Some commodity futures contracts have historically traded in contango markets. Although some commodity futures contracts have historically experienced periods of backwardation, it is possible that this backwardation will not be experienced in the future. The absence of backwardation in the commodity futures markets could result in negative "roll yields," which could adversely affect the value of the commodity index to which your securities are linked and, accordingly, decrease any amounts payable or property deliverable on the securities.

(66) Economic or political events or crises could result in large-scale purchases or sales of the reference asset, which could affect the price of the reference asset and may adversely affect the value of an investment in the securities.

Investors, institutions, governments and others may purchase and sell the reference asset as a hedge against inflation, market turmoil or uncertainty or political events. Under these circumstances, significant large-scale purchases or sales of the reference asset by market participants may affect the price of the reference asset, which could adversely affect the value of an investment in the securities.

(67) Substantial sales of the reference asset by governments or public sector entities could result in price decreases, which would adversely affect the value of an investment in the securities.

Governments and other public sector entities, such as agencies of governments and multi-national institutions, may regularly buy, sell and hold the reference asset as part of the management of their reserves. In the event that economic, political or social conditions or pressures require or motivate public sector entities to sell the reference asset, in a coordinated or uncoordinated manner, the resulting purchases could cause the price of the reference asset to decrease substantially, which could adversely affect the value of an investment in the securities.

(68) Changes in the Treasury Bill rate of interest may affect the value of a commodity index and the value of securities linked to that commodity index.

If the value of a commodity index is linked, in part, to the Treasury Bill rate of interest that could be earned on cash collateral invested in specified Treasury Bills, changes in the Treasury Bill rate of interest may affect any amount payable or property deliverable on any securities linked to that commodity index and, therefore, the market value of those commodity linked securities. Assuming the trading prices of the commodity components included in the commodity index remain constant, a decrease in the Treasury Bill rate of interest will adversely impact the value of the commodity index and, therefore, the value of the commodity-linked securities.

(69) You will not have any rights against any sponsor or administrator of a commodity index.

You will have no rights against any sponsor or administrator of a commodity index, even if any amounts payable or property deliverable on the securities depend on movements in the level, value or price of that commodity index. No sponsor or administrator of a commodity index is in any way involved in any offering of the securities nor has any obligations relating to the securities or to the holders of the securities. You will not own or have any beneficial or other legal interest in, and will not be entitled to any rights with respect to, a commodity index or options, swaps or other products based upon the level, value or price of that commodity index.

Additional Risks Relating to Securities with Reference Assets That Are Currencies, Indices of Currencies or Exchange-Traded Funds That Hold Currencies

The use of the term "reference asset(s)" under this subsection may refer to currencies, an index composed of currencies and/or an exchange-traded fund that holds currencies.

(70) Securities relating to currencies may be subject to foreign exchange risk.

The price relationship between two different currencies (e.g., the U.S. dollar and the Indian rupee) can be highly volatile and varies based on a number of interrelated factors, including the supply of and demand for each currency, political, economic, legal, financial, accounting and tax matters and other actions that we cannot control. Relevant factors include, among other things, the possibility that exchange controls could be imposed or modified, the possible imposition of other regulatory controls or taxes, the overall growth and performance of the local economies, the trade and current account balance between the relevant countries, market interventions by the central banks, inflation, interest rate levels, the performance of the global stock markets, the stability of the relevant governments and banking systems, wars, major natural disasters and other foreseeable and unforeseeable events. In addition, the value of a currency may be affected by the operation of, and the identity of persons and entities trading on, interbank and interdealer foreign exchange markets. These factors may adversely affect the performance of the reference

assets or their components and, as a result, the market value of the securities and any amounts payable or property deliverable on the securities.

(71) You will not have any rights to receive the reference assets or their components.

Investing in the securities will not make you a holder of any currency or futures contract relating to any currency. The securities will be paid in U.S. dollars or the specified currency stated in the applicable pricing supplement, and you will have no right to receive delivery of any currency or futures contract relating to any currency. Further, the return on your securities linked to any currency will not reflect the return you would realize if you directly purchased, invested in or traded that currency or instruments related to that currency.

(72) The liquidity and market value of the securities and any amounts payable or property deliverable on the securities could be suddenly and severely affected by the actions of the relevant sovereign governments.

Currency exchange rates of most economically developed nations are "floating," meaning the rate is permitted to fluctuate in value. However, governments, from time to time, may not allow their currencies to float freely in response to economic forces. Moreover, governments, including the government of the United States, use a variety of techniques, such as intervention by their central bank or imposition of regulatory controls or taxes, to affect the currency exchange rates of their respective currencies. Governments also may issue a new currency to replace an existing currency or alter the currency exchange rate or relative exchange characteristics by devaluation or revaluation of a currency. Thus, a special risk in purchasing securities based on the relationships of one or more non-U.S. currencies to each other or to the U.S. dollar is that their liquidity, their value and any amounts payable or property deliverable on the securities could be suddenly and severely affected by the actions of sovereign governments which could change or interfere with currency valuation and the movement of currencies across borders. Subject to calculation agent determinations in respect of certain events as described under "Reference Assets—Currency Exchange Rates—Adjustments Relating to Securities with a Currency Exchange Rate as a Reference Asset" below, there will be no adjustment or change in the terms of those securities in the event that currency exchange rates should become fixed, in the event of any devaluation, revaluation or imposition of exchange or other regulatory controls or taxes, in the event of the issuance of a replacement currency, or in the event of any other development affecting the relevant currencies.

(73) Suspensions or disruptions of market trading in the currency markets may adversely affect the market value of the securities and any amounts payable or property deliverable on the securities.

The currency markets are subject to temporary distortions or other disruptions due to various factors, including lack of liquidity in the currency markets, the participation of speculators and government regulation and intervention. These circumstances may adversely affect the performance of the reference assets or their components and, as a result, may adversely affect any amounts payable or property deliverable on the securities or the market value of the securities.

(74) Securities linked to emerging market currencies carry additional risks.

An investment linked to emerging market currencies involves many risks beyond those involved in an investment linked to the currencies of developed markets, including, but not limited to: economic, social, political, financial and military conditions in the emerging markets, including especially political uncertainty and financial instability; the increased likelihood of restrictions on export or currency conversion in the emerging markets; the greater potential for an inflationary environment in the emerging markets; the possibility of nationalization or confiscation of assets; the greater likelihood of regulation by the national, provincial and local governments of the emerging market countries, including the imposition of currency exchange controls and taxes; and less liquidity in emerging market currency markets than in those of developed markets. The currencies of emerging markets may be more volatile than those of developed markets and may be affected by political and economic developments in different ways than developed markets. Moreover, the emerging market economies may differ, potentially unfavorably, from developed market economies in a variety of ways, including growth of gross national product, rate of inflation, capital reinvestment, resources and self-sufficiency.

(75) Currency exchange risks can be expected to heighten in periods of financial crisis.

In periods of financial crisis, capital can move quickly out of regions that are perceived to be more vulnerable to the effects of the crisis than other regions with sudden and severely adverse consequences to the currencies of those regions that are perceived to be more vulnerable. In addition, governments around the world, including the United States and governments issuing other major world currencies, have recently made, and may be expected to continue to make, very significant interventions in their economies, and sometimes directly in their currencies. These interventions may affect currency exchange rates globally and, in particular, may affect the value of the currencies underlying the currency exchange rate to which your securities may be linked. Further interventions, other government actions or suspensions of actions, as well as other changes in government financial, economic or monetary policy or other financial, economic or monetary events affecting the currency markets, may cause currency exchange rates to fluctuate sharply in the future, which could have a material adverse effect on the value of the securities and your return on your investment in the securities.

(76) The formula for calculating the return of any currency exchange rate to which the securities are linked may have a significant adverse effect on your return on the securities. You should carefully consider the formulas used to calculate the return of any currency exchange rate to which the securities are linked.

The securities may be linked to the return of one or more currency exchange rates. If the applicable pricing supplement specifies that the return of the currency exchange rate is expressed as (a) the initial exchange rate minus the final exchange rate divided by (b) the initial exchange rate or as (a) the final exchange rate minus the initial exchange rate divided by (b) the final exchange rate, then in no event will the return of the currency exchange rate be equal to or greater than 100%, even though the return of the currency exchange rate may be less than -100%.

In addition, under these circumstances, the method of calculating the return of the currency exchange rate to which the securities are linked will result in (a) a less than 1-to-1 increase in the return on the currency exchange rate if the currency to which the securities provide long exposure (which we refer to as the "long currency") strengthens relative to the currency to which the securities provide short exposure (which we refer to as the "short currency") and (b) a greater than 1-to-1 decrease in the return on the currency exchange rate if the long currency weakens relative to the short currency.

This means that if the long currency strengthens relative to the short currency by a certain percentage, the corresponding return on the currency exchange rate to which the securities are linked will increase by a smaller percentage. Conversely, if the long currency were to weaken relative to the short currency by a certain percentage, the corresponding return on the currency exchange rate to which the securities are linked will decrease by a greater percentage.

In addition, if the securities are linked to a basket, significant depreciation of any single long currency relative to the short currency could offset significant appreciation by the other basket components.

For example, assuming (i) the securities are linked to a currency exchange rate that is quoted as the amount (a specified number) of the long currency that can be exchanged for one unit of the short currency, (ii) the return of the currency exchange rate is expressed as (a) the initial exchange rate minus the final exchange rate divided by (b) the initial exchange rate, and (iii) the initial exchange rate for the long currency relative to the short currency is 1.0. Based on the above assumptions, if the long currency appreciates relative to the short currency by 10% such that the final exchange rate is 0.9091, the return of the currency exchange rate will only be 9.09%; conversely, if the long currency depreciates relative to the short currency by 10% such that the final exchange rate is 1.1111, the return of the currency exchange rate will be -11.11%. Further, if the long currency appreciates relative to the short currency by 30% such that the final exchange rate is 0.7692, the return of the currency exchange rate will only be 23.08%; conversely, if the long currency depreciates relative to the short currency by 30% such that the final exchange rate is 1.4286, the return of the currency exchange rate will be -42.86%.

As illustrated above, the method of calculating the return of the currency exchange rate also will also result in (i) the value of the reference asset increasing at a diminishing rate the greater the appreciation of the long currency relative to the short currency, and (ii) the value of the reference asset decreasing at an increasing rate the greater the depreciation of the long currency relative to the short currency.

Accordingly, any amounts payable or property deliverable on the securities may be less than if you had invested in similar securities that use a different method for calculating currency returns or if you had invested directly in the relevant currencies.

You should carefully consider the formulas used to calculate the return of any currency exchange rate to which the securities are linked, which we will set forth in the applicable pricing supplement.

Additional Risks Relating to Notes with a Reference Asset That Is a Floating Interest Rate, an Index Containing Floating Interest Rates or Based in Part on a Floating Interest Rate

(77) You may receive a lesser amount of interest in the future.

Because the reference asset(s) will be composed of or based in part on a floating interest rate, there will be significant risks not associated with a conventional fixed-rate debt security. These risks include fluctuation of the applicable interest rate and the possibility that, in the future, you will receive a lesser amount of interest or no interest at all. We have no control over a number of matters that may affect interest rates, including economic, financial and political events that are important in determining the existence, magnitude and longevity of these risks and their results. Interest rates have been volatile in recent years and could remain volatile in the future.

(78) The interest rate may be below the rate otherwise payable on similar notes with a floating interest rate issued by us or another issuer with the same credit rating.

Because the reference asset(s) will be composed of or based in part on a floating interest rate, you may receive a rate of interest that is less than the rate of interest on other debt securities with the same maturity issued by us or an issuer with the same credit rating.

(79) The notes may be subject to a maximum interest rate, which will limit your return.

If the reference asset(s) are composed of or based in part on a floating interest rate, the notes may be subject to a maximum interest rate. In addition, the rate of interest that will accrue will never exceed the maximum rate permitted by New York law, as modified by federal law.

(80) The interest rate on the notes could be zero.

We have no control over fluctuations in the level, value or price of a reference asset. If the interest payments depend on a formula that uses a reference asset as a variable, certain values of that reference asset may result in a calculation that equals zero. In that case, no interest may accrue for the related interest payment period.

(81) Changes in the method pursuant to which a floating interest rate is determined may adversely affect the value of your notes.

The method by which any floating interest rate is calculated may change in the future, as a result of governmental actions, actions by the publisher of the applicable floating interest rate or otherwise. We cannot predict whether the method by which the applicable floating interest rate is calculated will change or what the impact of any change might be. Any of these changes could adversely affect the applicable floating interest rate, the market value of the securities and any amounts payable or property deliverable on the securities.

In particular, LIBOR and other rates that are deemed "benchmarks" are the subject of recent national, international and other regulatory guidance and proposals for reform. Some of these reforms are already effective while others are still to be implemented. These reforms may cause these "benchmarks" to perform differently than in the past, or to disappear entirely, or have other consequences which cannot be predicted. Any of these consequences could adversely affect any securities based on, or linked to, these "benchmarks." Any of these international, national or other proposals for reform or the general increased regulatory scrutiny of "benchmarks" could increase the costs and risks of administering or otherwise participating in the setting of a "benchmark" and complying with any of these regulations or requirements. These factors may have the effect of discouraging market participants from continuing to administer or participate in certain "benchmarks," trigger changes in the rules or methodologies used in certain "benchmarks" or lead to the disappearance of certain "benchmarks." The disappearance of a "benchmark" or changes in the manner of administration of a "benchmark" could result in adjustment to the terms and conditions, early redemption, discretionary valuation by the calculation agent, delisting or other consequence in relation to securities linked to that "benchmark." Any of these consequences could adversely affect the market value of the securities and any amounts payable or property deliverable on the securities.

Additional Risks Relating to Securities Based on a Basket Composed of More Than One Reference Asset

(82) Baskets are not recognized market indices and, therefore, may not accurately reflect market performance.

Unless otherwise specified in the applicable pricing supplement, a basket composed of more than one reference asset will not be a recognized market index and will be created solely for purposes of the offering of the securities and calculated solely during the term of the securities. In that instance, the level, value or price of a basket and, therefore, its performance will not be published as a separate index during the term of the securities. A basket composed of more than one reference asset might not be reflective of any particular market sector or economic measure but may instead represent a particular exposure created in connection with the particular offering of securities.

(83) Risks associated with the basket may adversely affect the market price of the securities and any amounts payable or property deliverable on your securities.

Because the basket to which securities may be linked may consist of a limited number of reference assets, the basket may be less diversified than funds or portfolios investing in broader markets and, therefore, could experience greater volatility.

If the basket is concentrated in a geographic region, an industry or group of industries or a particular economic sector, the basket and any amounts payable or property deliverable on the securities will be subject to concentration risks. These include the risks that the levels, values or prices of other assets in these geographic regions, industries or economic sectors or the prices of securities or other components of the reference assets composing the basket may decline, thereby adversely affecting the market value of the securities and any amounts payable or property deliverable on the securities. For example, a financial crisis could erupt in a particular geographic region, industry or economic sector and lead to sharp declines in the currencies, stock markets and other asset prices in that geographic region, industry or economic sector, threatening the particular financial systems, disrupting economies and causing political upheaval. Accordingly, the market value of the securities and any amounts payable or property deliverable on the securities may be adversely affected if the basket provides concentrated exposure.

(84) Correlation (or lack of correlation) of performances among the basket components may adversely affect your return on the securities, and changes in the value of one or more of the basket components may offset each other.

"Correlation" is the term used to describe the relationship between the percentage change among the basket components. Movements in the values of basket components may not correlate with each other. At a time when the value of a basket component increases in value, the value of the other basket components may not increase as much, or may even decline in value. Therefore, in calculating the basket's performance, an increase in the value of a basket component may be moderated, or wholly offset, by lesser increases or declines in the value of other basket components. Further, if the basket components are unequally weighted, increases in the value(s) of the lower-weighted basket component(s) may be offset by even small decreases in the value(s) of the more heavily weighted basket component(s). On the other hand, high correlation of movements in the values of the basket components could adversely affect your return on the securities during periods of negative performance of the basket components. Changes in the correlation of the basket components may adversely affect the market value of the securities.

Additional Risks Relating to Securities Payable in a Currency Other Than U.S. Dollars

(85) The unavailability of non-U.S. currencies could result in a substantial loss to you.

Banks may not offer non-U.S. dollar denominated checking or savings account facilities in the United States. Accordingly, payments on non-U.S. dollar denominated securities will be made from an account with a bank located in the country issuing the specified currency. As a result, you may have difficulty converting or be unable to convert those specified currencies into U.S. dollars on a timely basis or at all.

(86) Changes in non-U.S. currency exchange rates and foreign exchange controls could result in a substantial loss to you.

An investment in securities denominated in a specified currency other than U.S. dollars entails significant risks that are not associated with a similar investment in a security denominated in U.S. dollars. Risks include, without limitation, the possibility of significant changes in rates of exchange between the U.S. dollar and the relevant non-U.S. currencies or composite currencies and the possibility of the imposition or modification of foreign exchange controls by either the United States or non-U.S. governments. These risks generally depend on factors over which we have no control, such as economic and political events or the supply of and demand for the relevant currencies. In recent periods, rates of exchange between the U.S. dollar and certain non-U.S. currencies have been highly volatile and that volatility could continue in the future. If a security is non-U.S. dollar denominated, changes in rates of exchange between the U.S. dollar and the relevant non-U.S. currency could adversely affect the value of your security, and in the case of a note, could lower the effective yield of the note below its interest rate, and in some circumstances could result in a loss to the investor on a U.S. dollar basis.

Governments have imposed, and may in the future impose, exchange controls that could affect currency exchange rates, as well as the availability of a specified non-U.S. currency for making payments with respect to a non-U.S. dollar denominated security. There can be no assurance that exchange controls will not restrict or prohibit payments in any of those currencies or currency units. Even if there are no actual exchange controls, it is possible that the specified currency for any particular security would not be available to make payments when due. In that event, unless otherwise specified in the applicable pricing supplement, we will pay cash amounts due on the securities in U.S. dollars on the basis of the most recently available currency exchange rate.

(87) Securities payable in a non-U.S. currency may permit us to make payments in U.S. dollars or delay payment if we are unable to obtain the specified currency.

Securities payable in a currency other than U.S. dollars may provide that, if the other currency is subject to convertibility or transferability restrictions, market disruption or other conditions affecting its availability at or about the time when a payment on the securities comes due because of circumstances beyond our control, we will be entitled to make the payment in U.S. dollars or delay making the payment. We will describe these provisions in the pricing supplement relating to your securities. These circumstances could include the imposition of exchange controls or our inability to obtain the other currency because of a disruption in the currency markets. If we made payment in U.S. dollars, the currency exchange rate we would use for the securities would be determined in the manner described, in the case of notes, under "Terms of the Notes—Payment and Paying Agent," and in the case of warrants, under "Terms of the Warrants—Payment and Paying Agent." A determination of this kind may be based on limited information and would involve significant discretion on the part of the exchange rate agent appointed by us. As a result, the value of the payment in U.S. dollars an investor would receive on the payment date may be less than the value of the payment the investor would have received in the other currency if it had been available, or may be zero. In addition, a government may impose extraordinary taxes on transfers of a currency. If that happens, we will be entitled to deduct these taxes from any payment on securities payable in that currency.

(88) We will not adjust non-U.S. dollar denominated securities to compensate for changes in currency exchange rates.

Except as described in the applicable pricing supplement, we will not make any adjustment or change in the terms of a non-U.S. dollar denominated security in the event of any change in currency exchange rates for the relevant currency, whether in the event of any devaluation, revaluation, substitution of a new currency, or imposition of exchange or other regulatory controls or taxes or in the event of other developments affecting that currency, the U.S. dollar or any other currency. Consequently, investors in non-U.S. dollar denominated securities will bear the risk that their investment may be adversely affected by these types of events.

(89) In a lawsuit for payment on a non-U.S. dollar denominated security, you may bear currency exchange risk.

Our securities will be governed by New York law. Under Section 27 of the New York Judiciary Law, a state court in the State of New York rendering a judgment on a security denominated in a currency other than U.S. dollars would be required to render the judgment in the specified currency; however, the judgment would be converted into U.S. dollars at the currency exchange rate prevailing on the date of entry of the judgment. Consequently, in a lawsuit for payment on a security denominated in a currency other than U.S. dollars, U.S. dollar-based investors would bear currency exchange risk until judgment is entered, which could be a long time.

In courts outside of New York, investors may not be able to obtain judgment in a specified currency other than U.S. dollars. For example, a judgment for money in an action based on a non-U.S. dollar denominated security in many other U.S. federal or state courts ordinarily would be enforced in the United States only in U.S. dollars. The date used to determine the rate of conversion of the currency in which any particular security is denominated into U.S. dollars will depend upon various factors, including which court renders the judgment.

Additional Risks Relating to Securities That We May Call or Redeem (Automatically or Otherwise)

(90) Market factors may influence whether we exercise our right to call or redeem the securities prior to their scheduled maturity or prior to the relevant exercise date or period, as applicable.

It is possible that we will call or redeem the securities prior to the maturity date or prior to the exercise date or period, as applicable. If the securities are redeemed prior to their maturity date or prior to the exercise date or period, as applicable, you may be subject to reinvestment rate risk whereby it is likely that you will be unable to invest in securities with similar risk and yield as the securities in which you originally invested. Your ability to realize market value appreciation is limited by our right to call the securities prior to the maturity date or prior to the exercise date or period, as applicable.

(91) If subject to an automatic call, the appreciation potential of the securities is limited.

Any gain on the securities will be limited to the call premium, if any, applicable to the date on which the securities are called, regardless of the appreciation of the reference asset, which may be greater than the applicable call premium. In addition, the automatic call feature of the securities may shorten the term of your investment.

Additional Risks Relating to Warrants

(92) The warrants may expire worthless.

You will receive a cash payment or warrant property upon exercise (including automatic exercise, if applicable) only if the warrant has a settlement value greater than zero at that time. The settlement value will be greater than zero only if the value of the reference asset from the initial valuation date to the applicable valuation date is favorable. If the value of the reference asset is less than (or, in the case of put warrants, greater than) or equal to the initial value of the reference asset, the warrants will expire worthless. You should therefore be prepared to lose all or some of your investment in the warrants you purchase. In some cases you may not be able to determine, at the time of exercise of your warrant, the value of the reference asset that will be used in calculating the settlement value of your warrant. Therefore, you may be unable to determine the settlement value you are entitled to receive when making the decision to exercise that warrant. Potential profit or loss upon exercise (including automatic exercise, if applicable) of a warrant will be a function of the settlement value of that warrant, the purchase price of that warrant and any related transaction costs.

Because warrants may become worthless upon expiration, you must generally be correct about the direction, timing and magnitude of anticipated changes in the level of the reference asset in order to receive a positive return on your investment.

(93) The return on the warrants may be significantly less than the return on conventional debt securities.

Your return on the warrants may be less than the return you could earn on other investments. Because the settlement amount may be equal to or less than the issue price, the effective yield to maturity on the warrants may be less than that which would be payable on a conventional fixed-rate debt security with the same maturity issued by a company with a credit rating comparable to ours. Furthermore, any return may not compensate you for any opportunity cost implied by inflation and other factors relating to the time value of money.

(94) The warrants are suitable only for investors with options-approved accounts.

The warrants will be sold only to investors with options-approved accounts. You should therefore be experienced with respect to options and options transactions and you should reach an investment decision with respect to the warrants only after carefully considering the suitability of the warrants in light of their particular circumstances. The warrants are not suitable for persons solely dependent upon a fixed income, for individual retirement plan accounts or for accounts under the U.S. Uniform Transfers to Minors Act or Uniform Gifts to Minors Act.

(95) The warrants are not standardized options issued by the Options Clearing Corporation.

The warrants are not standardized options of the type issued by the U.S. Options Clearing Corporation ("OCC"), a clearing agency regulated by the SEC. For example, unlike purchasers of OCC standardized options who have the credit benefits of guarantees and margin and collateral deposits by OCC clearing members to protect the OCC from a clearing member's failure, you must look solely to us for performance of our obligations to pay or deliver the amount of money or warrant property payable or deliverable, if any, on the payment or settlement date of the applicable warrants. Further, the market for warrants is not expected to be as liquid as the market for OCC standardized options.

U.K. BAIL-IN POWER

Agreement with Respect to the Exercise of U.K. Bail-in Power

Notwithstanding any other agreements, arrangements or understandings between Barclays Bank PLC and any holder of the securities, by acquiring the securities, each holder of the securities acknowledges, accepts, agrees to be bound by, and consents to the exercise of, any U.K. Bail-in Power (as defined below) by the relevant U.K. resolution authority (as defined below) that may result in (i) the reduction or cancellation of all, or a portion, of the principal amount of, interest on, or any other amounts payable on, the securities; (ii) the conversion of all, or a portion, of the principal amount of, interest on, or any other amounts payable on, the securities into shares or other securities or other obligations of Barclays Bank PLC or another person (and the issue to, or conferral on, the holder of the securities such shares, securities or obligations); and/or (iii) the amendment or alteration of the maturity of the securities, or amendment of the amount of interest or any other amounts due on the securities, or the dates on which interest or any other amounts become payable, including by suspending payment for a temporary period; which U.K. Bail-in Power may be exercised by means of a variation of the terms of the securities solely to give effect to the exercise by the relevant U.K. resolution authority of such U.K. Bail-in Power. Each holder of the securities further acknowledges and agrees that the rights of the holders of the securities are subject to, and will be varied, if necessary, solely to give effect to, the exercise of any U.K. Bail-in Power by the relevant U.K. resolution authority. For the avoidance of doubt, this consent and acknowledgment is not a waiver of any rights holders of the securities may have at law if and to the extent that any U.K. Bail-in Power is exercised by the relevant U.K. resolution authority in breach of laws applicable in England.

For these purposes, a "U.K. Bail-in Power" is any write-down, conversion, transfer, modification and/or suspension power existing from time to time under any laws, regulations, rules or requirements relating to the resolution of banks, banking group companies, credit institutions and/or investment firms incorporated in the United Kingdom in effect and applicable in the United Kingdom to Barclays Bank PLC or other members of the Group, including but not limited to any such laws, regulations, rules or requirements that are implemented, adopted or enacted within the context of any applicable European Union directive or regulation of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and/or within the context of a U.K. resolution regime under the U.K. Banking Act 2009, as the same has been or may be amended from time to time (whether pursuant to the U.K. Financial Services (Banking Reform) Act 2013 (the "Banking Reform Act 2013"), secondary legislation or otherwise, the "Banking Act"), pursuant to which obligations of a bank, banking group company, credit institution or investment firm or any of its affiliates can be reduced, cancelled, amended, transferred and/or converted into shares or other securities or obligations of the obligor or any other person (and a reference to the "relevant U.K. resolution authority" is to any authority with the ability to exercise a U.K. Bail-in Power and the "Group" refers to Barclays PLC (or any successor entity) and its consolidated subsidiaries).

No repayment of the principal amount of the securities or payment of interest or any other amounts payable on the securities shall become due and payable after the exercise of any U.K. Bail-in Power by the relevant U.K. resolution authority unless such repayment or payment would be permitted to be made by Barclays Bank PLC under the laws and regulations of the United Kingdom and the European Union applicable to Barclays Bank PLC.

By its acquisition of the notes, each holder of the notes, to the extent permitted by the Trust Indenture Act, waives any and all claims against the trustee for, agrees not to initiate a suit against the trustee in respect of, and agrees that the trustee shall not be liable for, any action that the trustee takes, or abstains from taking, in either case in accordance with the exercise of the U.K. Bail-in Power by the relevant U.K. resolution authority with respect to the notes.

Upon the exercise of the U.K. Bail-in Power by the relevant U.K. resolution authority with respect to the notes, Barclays Bank PLC shall provide a written notice to DTC as soon as practicable regarding such exercise of the U.K. Bail-in Power for purposes of notifying holders of such occurrence. Barclays Bank PLC shall also deliver a copy of such notice to the trustee for information purposes.

By its acquisition of the notes, each holder of the notes acknowledges and agrees that the exercise of the U.K. Bail-in Power by the relevant U.K. resolution authority with respect to the notes shall not give rise to a default for

purposes of Section 315(b) (Notice of Defaults) and Section 315(c) (Duties of the Trustee in Case of Default) of the Trust Indenture Act.

Barclays Bank PLC's obligations to indemnify the trustee in accordance with the senior debt indenture shall survive the exercise of the U.K. Bail-in Power by the relevant U.K. resolution authority with respect to any notes.

With respect to the notes, by its acquisition of the notes, each holder of the notes acknowledges and agrees that, upon the exercise of any U.K. Bail-in Power by the relevant U.K. resolution authority, (a) the trustee shall not be required to take any further directions from holders of the notes under Section 5.12 (Control by Holders) of the senior debt indenture, which authorizes holders of a majority in aggregate outstanding principal amount of the notes to direct certain actions relating to the notes, and (b) the senior debt indenture shall impose no duties upon the trustee whatsoever with respect to the exercise of any U.K. Bail-in Power by the relevant U.K. resolution authority. Notwithstanding the foregoing, if, following the completion of the exercise of the U.K. Bail-in Power by the relevant U.K. resolution authority in respect of the notes, the notes remain outstanding (for example, if the exercise of the U.K. Bail-in Power results in only a partial write-down of the principal of such notes), then the trustee's duties under the senior debt indenture shall remain applicable with respect to the notes following such completion to the extent that Barclays Bank PLC and the trustee shall agree pursuant to a supplemental indenture or an amendment thereto.

By its acquisition of the notes, each holder of the notes shall be deemed to have (a) consented to the exercise of any U.K. Bail-in Power as it may be imposed without any prior notice by the relevant U.K. resolution authority of its decision to exercise such power with respect to the notes and (b) authorized, directed and requested DTC and any direct participant in DTC or other intermediary through which it holds the notes to take any and all necessary action, if required, to implement the exercise of any U.K. Bail-in Power with respect to the notes as it may be imposed, without any further action or direction on the part of such holder or the trustee.

Under the terms of the notes, the exercise of the U.K. Bail-in Power by the relevant U.K. resolution authority with respect to the notes will not be a default or an Event of Default (as each term is defined in the senior debt indenture).

If any securities provide for the delivery of property, any reference in this prospectus supplement, the accompanying prospectus and the relevant pricing supplement to payment by Barclays Bank PLC under the securities will be deemed to include that delivery of property.

For the avoidance of doubt, references to "you" and "holder" in this "U.K. Bail-in Power" section include beneficial owners of the securities.

See "Risk Factors—Risks Relating to the Securities Generally—Regulatory action in the event a bank or investment firm in the Group is failing or likely to fail could materially adversely affect the value of the securities" and "—Under the terms of the securities, you have agreed to be bound by the exercise of any U.K. Bail-in Power by the relevant U.K. resolution authority" in this prospectus supplement.

Subsequent Holders' Agreement

Holders of securities that acquire such securities in the secondary market shall be deemed to acknowledge, agree to be bound by and consent to the same provisions described herein to the same extent as the holders of such securities that acquire the securities upon their initial issuance, including, without limitation, with respect to the acknowledgment and agreement to be bound by and consent to the terms of the securities, including in relation to the U.K. Bail-in Power.

Certain Definitions

"CRD IV" consists of Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, as the same may be amended or replaced from time to time and the CRD IV Regulation.

"CRD IV Regulation" means Regulation (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms of the European Parliament and of the Council of June 26, 2013, as the same may be amended or replaced from time to time.

"PRA" means the Prudential Regulation Authority of the United Kingdom or such other governmental authority in the United Kingdom (or if Barclays Bank PLC becomes domiciled in a jurisdiction other than the United Kingdom, such other jurisdiction) having primary responsibility for the prudential supervision of Barclays Bank PLC.

TERMS OF THE NOTES

General

You should carefully read the general terms and provisions of our debt securities in "Description of Debt Securities" in the accompanying prospectus. This section supplements that description. The pricing supplement for each offering of notes will contain the detailed information and terms for that particular offering. The pricing supplement also may add, update or change information contained in any applicable product supplement, any applicable index supplement, this prospectus supplement and the prospectus. If the terms described in the applicable pricing supplement are different from or inconsistent with those described in this prospectus supplement, in the prospectus, in any applicable product supplement or any applicable index supplement, the terms described in the applicable pricing supplement will control. Any pricing supplement should be read in connection with any applicable product supplement, any applicable index supplement, this prospectus supplement and the prospectus. It is important that you consider all of the information in the pricing supplement, any applicable product supplement, any applicable index supplement, this prospectus supplement and the prospectus when making your investment decision.

We will issue Global Medium-Term Notes, Series A, under the senior debt indenture between us and The Bank of New York Mellon. The senior debt indenture permits us to issue different series of debt securities from time to time. The medium-term notes are a single, distinct series of debt securities. We may, however, issue notes in any amounts, at any times and on any terms as we wish. The notes may differ from other notes issued pursuant to the series designated as our Global Medium-Term Notes, Series A, and from debt securities of other series, in their terms.

The notes constitute our direct, unconditional, unsecured and unsubordinated obligations ranking *pari passu*, without any preference among themselves, with all our other outstanding unsecured and unsubordinated obligations, present and future, except those obligations as are preferred by operation of law.

The notes are not deposit liabilities of Barclays Bank PLC and are not covered by the U.K. Financial Services Compensation Scheme or insured by the FDIC or any other governmental agency or deposit insurance agency of the United States, the United Kingdom or any other jurisdiction.

Note that the information about the price to the public and net proceeds to Barclays Bank PLC in the applicable pricing supplement relates only to the initial sale of the notes. If you have purchased the notes in a purchase/resale transaction after the initial sale, information about the price and date of sale to you will be provided in a separate confirmation of sale.

Payment at Maturity

The applicable pricing supplement will detail the payment at maturity. The payment at maturity may be based, or may be contingent, on movements in the level(s), value(s) or price(s) or other events relating to one or more reference assets, and if so, the formula or method of calculation and the relevant reference asset(s) will be specified in the applicable pricing supplement. See "Reference Assets" below for terms of the notes relating to any reference asset.

If so specified in the applicable pricing supplement, the payment at maturity may be made in shares of an equity security, with fractional shares paid in cash. Under these circumstances, the number of shares received is referred to as the "physical delivery amount." The physical delivery amount, the initial price of the linked shares and other amounts may change due to stock splits or other corporate actions. See "Reference Assets—Equity Securities—Share Adjustments Relating to Securities with an Equity Security as a Reference Asset" below.

Interest

The applicable pricing supplement will specify whether the notes bear interest. The applicable pricing supplement may specify that interest will accrue on the notes from the original issue date or any other date specified in the applicable pricing supplement either at a fixed rate or floating rate or at a rate based on a reference asset as specified in the applicable pricing supplement. See "Interest Mechanics" below. The applicable pricing supplement may instead specify that any interest will be based, or will be contingent, on movements in the level(s), value(s) or

price(s) or other events relating to one or more reference assets, and if so, the formula or method of calculation and the relevant reference asset(s) will be specified in the applicable pricing supplement. See "Reference Assets" below for terms of the notes relating to any reference asset.

In the case of any notes that do not bear interest at a fixed rate, any return on the notes that may be deemed to be interest will in no event be higher than the maximum rate permitted by New York law, as it may be modified by U.S. law of general application. Under current New York law, the maximum rate of interest, with some exceptions, for any loan in an amount less than $250,000 is 16% and for any loan in the amount of $250,000 or more but less than $2,500,000 is 25%, per year on a simple interest basis. These limits do not apply to loans of $2,500,000 or more.

Additional Amounts and Redemption for Tax Reasons

Unless otherwise specified in the relevant pricing supplement, the provisions in the accompanying prospectus described under "Description of Debt Securities—Additional Amounts" and "Description of Debt Securities—Redemption—Redemption of Senior Debt Securities for Tax Reasons" will not apply to the notes. Unless the relevant pricing supplement provides otherwise, we will pay any amounts to be paid by us on any series of debt securities without deduction or withholding for, or on account of, any and all present or future income, stamp and other taxes, levies, imposts, duties, charges, fees, deductions or withholdings now or hereafter imposed, levied, collected, withheld or assessed by or on behalf of the United Kingdom or any U.K. political subdivision or authority thereof or therein that has the power to tax, unless the deduction or withholding is required by law.

Early Redemption at Barclays Bank PLC's Option

The applicable pricing supplement will indicate whether we have the option to redeem the notes, in whole or in part, on any optional redemption date. The amount payable upon redemption, which we may refer to in a pricing supplement as the "redemption price," and any other terms related to our option to redeem the notes, will be specified in the applicable pricing supplement.

If we exercise any early redemption at our option, we will notify each holder, or in the case of global notes, the depositary, as holder of the global notes, within the redemption notice period specified in the applicable pricing supplement. The notes will not be subject to any sinking fund. See "Description of Debt Securities—Redemption" in the accompanying prospectus.

Automatic Early Redemption

The applicable pricing supplement will indicate whether the notes will be automatically "callable" or "redeemable" based on the level(s), value(s) or prices(s) of the reference asset(s) on one or more valuation dates. The amount payable upon an automatic call, which we may refer to in a pricing supplement as the "call price" or "redemption price," and any other terms related to the automatic call provision, will be specified in the applicable pricing supplement.

Repurchase at Option of the Holder

The applicable pricing supplement will indicate whether the holder has the option to require us to repay the note on a date or dates specified prior to its maturity date. If applicable, the repurchase price, and any other terms related to the holder's repurchase option, will be specified in the applicable pricing supplement.

Exercise of the repurchase option by the holder of a note will be irrevocable. Unless otherwise specified in the relevant terms supplement, the holder may exercise the repurchase option for less than the entire principal amount of the note but, in that event, the principal amount of the note remaining outstanding after repurchase must be an authorized denomination.

Special Requirements for Optional Repayment of Global Notes

Since the notes are represented by global notes, the depositary or depositary's nominee will be the holder of the notes and therefore will be the only entity that can exercise a right to require repayment prior to the stated maturity. To ensure that the depositary's nominee will timely exercise a right to require repayment of a particular note prior to the stated maturity, the beneficial owner of the note must instruct the broker or other direct or indirect participant

through which it holds an interest in the note to notify the depositary of its desire to exercise a right to require repayment prior to the stated maturity. Different brokerage firms may have different deadlines for accepting instructions from their customers. Accordingly, each beneficial owner of the note should consult the broker or other direct or indirect participant through which it holds an interest in a note in order to ascertain the cut-off time by which an instruction must be given for timely notice to be delivered to the depositary.

Payment Dates

The applicable pricing supplement will specify the maturity date and any date preceding the maturity date on which amounts will or may be payable with respect to the notes. We refer to the maturity date and each of these other dates as a "payment date." Unless otherwise stated in the applicable pricing supplement, each payment date will be governed by the "following business day" convention (*i.e.*, if the applicable payment date stated in the applicable pricing supplement is not a business day, that payment date will be extended to the next following business day) and will be "unadjusted" (*i.e.,* the relevant payment will be made on the following business day in accordance with the designated business day convention with the same effect as if paid on the originally scheduled payment date).

If the valuation date with respect to any payment date preceding the maturity date is postponed, the relevant payment date will be postponed by the same number of business days from but excluding the originally scheduled valuation date to and including the actual valuation date.

If the final valuation date is postponed, the maturity date will be postponed by the same number of business days from but excluding the originally scheduled final valuation date to and including the actual final valuation date.

If the notes are linked to a basket of multiple assets or to the best or worst performing in a group of reference assets (in either case, other than a basket or a group of reference assets containing only equity securities, exchange-traded funds and/or indices of equity securities), the valuation date or final valuation date, for purposes of the preceding two paragraphs, will be deemed to have occurred on the earliest date on which the levels, values or prices for the all basket components or reference assets, as applicable, have been determined.

Unless otherwise specified in the applicable pricing supplement, in the event that a payment date is extended or postponed as described above, any amount payable on the notes on that payment date will be made, without additional interest, on the postponed payment date.

Valuation Dates, Review Dates, Determination Dates, Observation Dates and Averaging Dates

We refer to each date on which the level, value or price of any reference asset is to be referenced in the determination of any payment on the notes as a "valuation date." The applicable pricing supplement may also refer to a valuation date as an "observation date," a "review date," a "determination date" or an "averaging date." We refer to date on which the notes are initially priced for sale to the public as the "initial valuation date," and such date will, unless otherwise set forth in the applicable pricing supplement, be the date on which the initial level, initial value or initial price of a reference asset is established. We refer to the valuation date on which the final level, final value or final price of a reference asset is established as the "final valuation date." For the avoidance of doubt, if the final level, final value or final price of a reference asset is based on the levels, values, or prices of that reference asset on multiple valuation dates (either consecutively near the end of the term of the notes or periodically throughout the term of the notes), the last of those valuation dates will be the "final valuation date."

Each valuation date will be specified in the applicable pricing supplement, *provided* that the calculation agent may postpone any valuation date if the calculation agent determines that the originally scheduled valuation date is not a scheduled trading day or that a market disruption event has occurred or is continuing on a day that would otherwise be that valuation date. We describe market disruption events and valuation date postponement for the various reference assets under "Reference Assets" below.

Business Day

As used in this prospectus supplement, and in the applicable pricing supplement unless otherwise defined therein, "business day" means any day that is a Monday, Tuesday, Wednesday, Thursday or Friday and that is not a day on which banking institutions in New York City generally are authorized or obligated by law, regulation or executive order to be closed.

Business Day Convention

Business day conventions are procedures used to adjust certain events (*e.g.*, interest payment dates and redemption dates) that fall on days that are not business days. Unless the applicable pricing supplement states otherwise, those events will be governed by the "following business day" convention (*e.g.*, if an interest payment date, redemption date or other event, as defined in the applicable pricing supplement, falls on a day that is not a business day, the interest payment date, redemption date or other event, as the case may be, will be the next following business day). As described under "Terms of the Notes—Payment Dates" above, each payment date will be subject to the "following business day" convention, unless otherwise specified in the applicable pricing supplement.

Following Business Day. Any payment on the notes that would otherwise be due on a day that is not a business day will instead be paid on the next day that is a business day.

Modified Following Business Day. Any payment on the notes that would otherwise be due on a day that is not a business day will instead be paid on the next day that is a business day, unless that day falls in the next calendar month, in which case the payment date will be the first preceding day that is a business day.

Preceding Business Day. Any payment on the notes that would otherwise be due on a day that is not a business day will instead be paid on the first preceding day that is a business day.

Nearest Business Day. Any payment on the notes that would otherwise be due on a day that is not a business day will instead be paid on the first preceding day that is a business day if the originally scheduled payment date would otherwise fall on a day other than a Sunday or a Monday and will be paid on the next day that is a business day if the originally scheduled payment date would otherwise fall on a Sunday or a Monday.

Day Count Convention

A day count convention is a method to calculate the fraction of a year between two dates. The applicable pricing supplement will specify the day count convention, if any.

ACT/360 or Actual/360. The actual number of days between two dates divided by 360.

30/360. Each month is deemed to have 30 days and the year is deemed to have 360 days.

ACT/ACT or Actual/Actual. The actual number of days between two dates divided by the actual number of days in the year.

ACT/365 or Actual/365 Fixed. The actual number of days between two dates, with the year deemed to have 365 days, regardless of leap year status.

NL/365. "No Leap Year" logic extension to ACT/365 where leap days are subtracted, ensuring the quotient never exceeds 1.

30/365. Extension to 30/360 where each month is deemed to have 30 days and the year is deemed to have 365 days.

ACT/366 or Actual/366. Extension to ACT/365 where the actual number of days between two dates is divided by 366, ensuring the quotient never exceeds 1.

ACT/252 or BUS/252 or Actual/252 or Business Days/252. The number of business days between two dates, divided by a nominal year deemed to have 252 business days. (Weekends and holidays are excluded; thus, Friday to Monday would be considered one business day.)

Payment and Paying Agent

Currency of Notes

Amounts that become due and payable on your notes in cash will be payable in a currency, composite currency, basket of currencies or currency unit or units ("specified currencies") specified in the applicable pricing supplement. The specified currency for your notes will be U.S. dollars, unless your pricing supplement states otherwise. Some notes may have different specified currencies for principal, interest or other amounts payable on your notes. We will make payments on your notes in the specified currency, except as described in the applicable pricing supplement. See "Risk Factors—Additional Risks Relating to Securities Payable in a Currency Other Than U.S. Dollars" in this prospectus supplement for more information about the risks of investing in this kind of note.

Payments Due in U.S. Dollars

We will follow the practices described below when paying amounts due in U.S. dollars.

Payments on Global Notes. We will make payments on a global note in accordance with the applicable policies of the depositary as in effect from time to time. Under those policies, we will pay directly to the depositary, or its nominee, and not to any indirect owners who own beneficial interests in the global note. An indirect owner's right to receive those payments will be governed by the rules and practices of the depositary and its participants, as described in the section entitled "Description of Debt Securities—Legal Ownership; Form of Debt Securities" in the accompanying prospectus.

Payments on Non-Global Notes. We will make payments on a note in non-global, registered form as follows. We will pay interest that is due on an interest payment date by check mailed on the interest payment date to the holder at his or her address shown on the trustee's records as of the close of business on the regular record date. We will make all other payments by check at the paying agent described below, against surrender of the note. All payments by check will be made in next-day funds—*i.e.*, funds that become available on the day after the check is cashed. Alternatively, if a non-global note has a principal amount of at least $1,000,000 and the holder asks us to do so, we will pay any amount that becomes due on the note by wire transfer of immediately available funds to an account at a bank in New York City, on the due date. To request wire payment, the holder must give the paying agent appropriate wire transfer instructions at least five business days before the requested wire payment is due. In the case of any interest payment due on an interest payment date, the instructions must be given by the person or entity who is the holder on the relevant regular record date. In the case of any other payment, payment will be made only after the note is surrendered to the paying agent. Any wire instructions, once properly given, will remain in effect unless and until new instructions are given in the manner described above.

Book-entry and other indirect owners should consult their banks or brokers for information on how they will receive payments on their notes.

For a description of the paying agent, see "Description of Debt Securities—Legal Ownership; Form of Debt Securities—Payment and Paying Agents" in the accompanying prospectus.

Payments Due in Non-U.S. Dollar Currencies

We will follow the practices described below when paying amounts that are due in a specified currency other than U.S. dollars.

Payments on Global Notes. We will make payments on a global note in accordance with the applicable policies of the depositary as in effect from time to time. We understand that these policies, as currently in effect at The Depository Trust Company ("DTC"), are as follows:

Unless otherwise indicated in your pricing supplement, if you are an indirect owner of global notes denominated in a specified currency other than U.S. dollars, you will not have the right to elect to receive payment in that other currency. If your pricing supplement indicates that you have the right to elect to receive payments in that other currency and you do make that election, you must notify the DTC participant through which your interest in the global note is held of your election:

- on or before the applicable regular record date, which will be specified in your pricing supplement, in the case of a payment of interest, or
- on or before the 16th day prior to stated maturity, or any redemption or repurchase date, in the case of payment of principal or any premium.

If any interest, principal or premium payment is due in a specified currency other than U.S. dollars, you may elect to receive all or only a portion of the payment in that other currency.

Your DTC participant must, in turn, notify DTC of your election on or before the 12th DTC business day prior to the interest payment date or stated maturity, as applicable, or on the redemption or repurchase date if your note is redeemed or repaid earlier, in the case of a payment of principal or any premium.

DTC, in turn, will notify the paying agent of your election in accordance with DTC's procedures.

If complete instructions are received by the DTC participant and forwarded by the DTC participant to DTC, and by DTC to the paying agent, on or before the dates noted above, the paying agent, in accordance with DTC's instructions, will make the payments to you or your DTC participant by wire transfer of immediately available funds to an account maintained by you or your DTC participant with a bank located in the country issuing the specified currency or in another jurisdiction acceptable to us and the paying agent.

If the foregoing steps are not properly completed, we expect DTC to inform the paying agent that payment is to be made in U.S. dollars. In that case, we or our agent will convert the payment to U.S. dollars in the manner described under "Terms of the Notes—Payment and Paying Agent—Payments Due in Non-U.S. Dollar Currencies—Conversion to U.S. Dollars." We expect that we or our agent will then make the payment in U.S. dollars to DTC, and that DTC in turn will pass it along to its participants.

Book-entry and other indirect holders of a global note denominated in a currency other than U.S. dollars should consult their banks or brokers for information on how to request payment in the specified currency.

Payments on Non-Global Notes. Except where otherwise requested by the holder as described below, we will make payments on notes in non-global form in the applicable specified currency. We will make these payments by wire transfer of immediately available funds to any account that is maintained in the applicable specified currency at a bank designated by the holder and that is acceptable to us and the trustee. To designate an account for wire payment, the holder must give the paying agent appropriate wire instructions at least five business days before the requested wire payment is due. In the case of any interest payment due on an interest payment date, the instructions must be given by the person who is the holder on the regular record date. In the case of any other payment, the payment will be made only after the note is surrendered to the paying agent. Any instructions, once properly given, will remain in effect unless and until new instructions are properly given in the manner described above.

If a holder fails to give instructions as described above, we will notify the holder at the address in the trustee's records and will make the payment within five business days after the holder provides appropriate instructions. Any late payment made in these circumstances will be treated under the senior debt indenture as if made on the due date, and no interest will accrue on the late payment from the due date to the date paid.

Although a payment on a note in non-global form may be due in a specified currency other than U.S. dollars, we will make the payment in U.S. dollars if the holder asks us to do so. To request U.S. dollar payment, the holder must provide appropriate written notice to the paying agent at least five business days before the next due date for which payment in U.S. dollars is requested. In the case of any interest payment due on an interest payment date, the request must be made by the person who is the holder on the regular record date. Any request, once properly made, will remain in effect unless and until revoked by notice properly given in the manner described above.

Indirect owners of a non-global note with a specified currency other than U.S. dollars should contact their banks or brokers for information about how to receive payments in the specified currency or in U.S. dollars.

Conversion to U.S. Dollars. When we make payments in U.S. dollars of an amount due in another currency, either on a global note or a non-global note as described above, we will determine the U.S. dollar amount the holder receives as follows. The exchange rate agent described below will request currency bid quotations expressed in U.S. dollars from three or, if three are not available, then two, recognized foreign exchange dealers in New York City,

any of which may be the exchange rate agent, which may be Barclays Capital Inc., an affiliate of Barclays Bank PLC, as of 11:00 a.m., New York City time, on the second business day before the payment date.

Currency bid quotations will be requested on an aggregate basis, for all holders of notes requesting U.S. dollar payments of amounts due on the same date in the same specified currency. The U.S. dollar amount the holder receives will be based on the highest acceptable currency bid quotation received by the exchange rate agent. If the exchange rate agent determines that at least two acceptable currency bid quotations are not available on that second business day, the payment will be made in the specified currency.

To be acceptable, a quotation must be given as of 11:00 a.m., New York City time, on the second business day before the due date and the quoting dealer must commit to execute a contract at the quotation in the total amount due in that currency on all series of notes. (If some but not all of the relevant notes are LIBOR notes or EURIBOR notes, the second preceding business day will be determined for this purpose as if none of those notes were LIBOR notes or EURIBOR notes.)

When we make payments to you in U.S. dollars of an amount due in another currency, you will bear all associated currency exchange costs, which will be deducted from the payment.

When the Specified Currency Is Not Available. If we are obligated to make any payment in a specified currency other than U.S. dollars, and the specified currency or any successor currency is not available to us or cannot be paid to you due to circumstances beyond our control—such as the imposition of exchange controls or a disruption in the currency markets—we will be entitled to satisfy our obligation to make the payment in that specified currency by making the payment in U.S. dollars, on the basis specified in the applicable pricing supplement.

The foregoing will apply to any note, whether in global or non-global form, and to any payment, including a payment at maturity. Any payment made under the circumstances and in a manner described above will not result in a default under any note or the senior debt indenture.

Exchange Rate Agent. If we issue a note in a specified currency other than U.S. dollars, we will appoint a financial institution to act as the exchange rate agent and will name the institution initially appointed when the note is originally issued in the applicable pricing supplement. We may select Barclays Capital Inc. or another of our affiliates to perform this role. We may change the exchange rate agent from time to time after the original issue date of the note without your consent and without notifying you of the change.

All determinations made by the exchange rate agent will be at its sole discretion unless we state in your pricing supplement that any determination is subject to our approval. In the absence of manifest error, those determinations will be conclusive for all purposes and final and binding on you and us, without any liability on the part of the exchange rate agent.

Calculations and Calculation Agent

Any calculations relating to the notes will be made by the calculation agent, an institution that we appoint as our agent for this purpose. Unless otherwise specified in the applicable pricing supplement, Barclays Bank PLC will act as calculation agent. We may appoint a different institution, including one of our affiliates, to serve as calculation agent from time to time after the original issue date of the notes without your consent and without notifying you of the change. We will ensure that there is a financial institution serving as the calculation agent at all relevant times.

The calculation agent will, in its sole discretion, make all determinations regarding any amounts payable in respect of your notes, the level(s), value(s) or price(s) of the reference asset(s), market disruption events, early redemption events, business days, the default amount upon any acceleration (only in the case of an event of default under the senior debt indenture), the maturity date, optional redemption dates, if any, the interest rate, if any, and any other calculations or determinations to be made by the calculation agent. Absent manifest error, all determinations of the calculation agent will be conclusive for all purposes and final and binding on you and us, without any liability on the part of the calculation agent.

The calculation agent is obligated to carry out its duties and functions as calculation agent in good faith and using reasonable judgment. However, in engaging in these activities the calculation agent will have no obligation to consider your interests as an investor in the notes, and if the calculation agent is Barclays Bank PLC or one of our affiliates, in making these discretionary judgments, it may have economic interests that are adverse to your interests as an investor in the notes and its determinations may adversely affect the value of and any return on your notes. You will not be entitled to any compensation from us for any loss suffered as a result of any of the above determinations by the calculation agent.

All percentages resulting from any calculation relating to a note will, unless otherwise specified in the applicable pricing supplement, be rounded upward or downward, as appropriate, to the next higher or lower one hundred-thousandth of a percentage point, e.g., 9.876544% (or .09876544) being rounded down to 9.87654% (or .0987654) and 9.876545% (or .09876545) being rounded up to 9.87655% (or .0987655). All amounts used in or resulting from any calculation relating to a note will, unless otherwise specified in the applicable pricing supplement, be rounded upward or downward, as appropriate, to the nearest cent, in the case of U.S. dollars, the nearest corresponding hundredth of a unit, in the case of a currency other than U.S. dollars, or to the nearest one hundred-thousandth of a unit, in the case of a currency exchange rate, with one-half cent, one-half of a corresponding hundredth of a unit or one-half of a hundred-thousandth of a unit or more being rounded upward.

In determining the level, value or price of a reference asset that applies to a note during a particular interest or other period, the calculation agent may obtain quotes from various banks or dealers active in the relevant market, as described under "Reference Assets" below. Those reference banks, dealers, reference asset sponsors or information providers may include the calculation agent itself and its affiliates, as well as any underwriter, dealer or agent participating in the distribution of the relevant notes and its affiliates, and they may include Barclays Bank PLC or its affiliates.

Default Amount

If an event of default occurs and the maturity of the notes is accelerated, we will pay the default amount in respect of the principal of the notes at maturity. We describe the default amount below under "Determination of Default Amount."

For the purpose of determining whether the holders of our medium-term notes, of which the notes are a part, are entitled to take any action under the senior debt indenture, we will treat the stated principal amount of each note outstanding as the principal amount of that note. Although the terms of your notes may differ from those of the other medium-term notes, holders of specified percentages in principal amount of all medium-term notes, together in some cases with other series of our debt securities, will be able to take action affecting all the medium-term notes, including your notes. This action may involve changing some of the terms that apply to the medium-term notes, accelerating the maturity of the medium-term notes after a default or waiving some of our obligations under the senior debt indenture. We discuss these matters in the attached prospectus under "Description of Debt Securities—Modification and Waiver," "Description of Debt Securities—Senior Events of Default; Dated Subordinated Events of Default and Debt Defaults" and "Description of Debt Securities—Limitation on Suits."

Determination of Default Amount

The default amount for the notes on any day will be an amount, determined by the calculation agent in its sole discretion, that is equal to the cost of having a qualified financial institution, of the kind and selected as described below, expressly assume all our payment and other obligations (including accrued and unpaid interest) with respect to the notes as of that day and as if no default or acceleration had occurred, or to undertake other obligations providing substantially equivalent economic value to you with respect to the notes. That cost will equal:

- the lowest amount that a qualified financial institution would charge to effect this assumption or undertaking, plus
- the reasonable expenses, including reasonable attorneys' fees, incurred by the holders of the notes in preparing any documentation necessary for this assumption or undertaking.

During the default quotation period for the notes, which we describe below, the holders of the notes and/or we may request a qualified financial institution to provide a quotation of the amount it would charge to effect this assumption or undertaking. If either party obtains a quotation, it must notify the other party in writing of the quotation. The amount referred to in the first bullet point above will equal the lowest—or, if there is only one, the only—quotation obtained, and as to which notice is so given, during the default quotation period. With respect to any quotation, however, the party not obtaining the quotation may object, on reasonable and significant grounds, to the assumption or undertaking by the qualified financial institution providing the quotation and notify the other party in writing of those grounds within two business days after the last day of the default quotation period, in which case that quotation will be disregarded in determining the default amount.

Notwithstanding the foregoing, if a voluntary or involuntary liquidation, bankruptcy or insolvency of, or any analogous proceeding is filed with respect to Barclays Bank PLC, then depending on applicable bankruptcy law, your claim may be limited to an amount that could be less than the default amount.

Default Quotation Period

The default quotation period is the period beginning on the day the default amount first becomes due and ending on the third business day after that day, unless:

- no quotation of the kind referred to above is obtained, or
- every quotation of that kind obtained is objected to within five business days after the due date as described above.

If either of these two events occurs, the default quotation period will continue until the third business day after the first business day on which prompt notice of a quotation is given as described above. If that quotation is objected to as described above within five business days after that first business day, however, the default quotation period will continue as described in the prior sentence and this sentence.

In any event, if the default quotation period and the subsequent two business day objection period have not ended before the final valuation date, or, in the case of notes linked to an interest rate, the maturity date, then the default amount will equal the principal amount of the notes.

Qualified Financial Institutions

For the purpose of determining the default amount at any time, a qualified financial institution must be a financial institution organized under the laws of any jurisdiction in the United States or Europe, which at that time has outstanding debt obligations with a stated maturity of one year or less from the date of issue and rated either:

- A-1 or higher by Standard & Poor's Ratings Services or any successor, or any other comparable rating then used by that rating agency, or
- P-1 or higher by Moody's Investors Service or any successor, or any other comparable rating then used by that rating agency.

INTEREST MECHANICS

How Interest Is Calculated

If applicable, interest on notes will accrue from and including the most recent interest payment date to which interest has been paid or duly provided for, or, if no interest has been paid or duly provided for, from and including the original issue date or any other date specified in the applicable pricing supplement on which interest begins to accrue. Interest will accrue to but excluding the next interest payment date or, the date on which the principal has been paid or duly made available for payment, except as described below.

Unless otherwise specified in the applicable pricing supplement, accrued interest on a floating rate note during an interest period with more than one interest reset date will be calculated by multiplying the principal amount of the note by an accrued interest factor. The accrued interest factor will be computed by adding the interest factors calculated for each day in the applicable interest period. Unless otherwise specified in the applicable pricing supplement, the interest factor for each day in the applicable interest period will be computed by dividing the interest rate in effect on that day by 360, in the case of notes linked to the commercial paper rate, federal funds (effective) rate, federal funds (open) rate, LIBOR, EURIBOR, prime rate, eleventh district cost of funds rate, Consumer Price Index or ICE Swap rate. In the case of notes linked to the CMT rate or Treasury rate, the interest factor for each day in the applicable interest period will be computed by dividing the interest rate in effect on that day by the actual number of days in the year, unless otherwise specified in the applicable pricing supplement. The interest factor will be expressed as a decimal calculated to seven decimal places without rounding. For purposes of making the foregoing calculation, the interest rate in effect on any interest reset date will be the applicable rate as reset on that date.

Unless otherwise specified in the applicable pricing supplement, for all other floating rate notes, accrued interest will be calculated by first multiplying the principal amount of the notes by the interest rate in effect during the applicable interest period. Unless otherwise specified in the applicable pricing supplement, that product is then multiplied by the quotient obtained by dividing the actual number of days in the period for which accrued interest is being calculated by 360, in the case of notes linked to the commercial paper rate, federal funds (effective) rate, federal funds (open) rate, LIBOR, EURIBOR, prime rate, eleventh district cost of funds rate, Consumer Price Index or ICE Swap rate. In the case of notes linked to the CMT or Treasury rate, the product is multiplied by the quotient obtained by dividing the actual number of days in the period for which accrued interest is being calculated by the actual number of days in the year, unless otherwise specified in the applicable pricing supplement.

Regular Record Dates for Interest

Global Notes

In the event that the notes are issued as “global notes,” the ultimate beneficial owners of the notes are indirect holders and interest will be paid to the person in whose name the notes are registered at the close of business on the regular record date before each interest payment date. Unless otherwise specified in the applicable pricing supplement, the regular record date relating to an interest payment date for the notes issued as “global notes” will be the date one business day prior to the interest payment date, whether or not that interest payment date is a business day; *provided* that for an interest payment date that is also the maturity date, the interest payable on that interest payment date will be payable to the person to whom the principal is payable. If the interest payment date is also a day on which principal is due, the interest payable will include interest accrued to, but excluding, the maturity date. If a note is issued between a record date and an interest payment date, the first interest payment will be made on the next succeeding interest payment date. For the purpose of determining the holder at the close of business on a regular record date, the close of business will mean 5:00 p.m., New York City time, on that day. See “Description of Debt Securities—Legal Ownership; Form of Debt Securities” in the accompanying prospectus.

Non-Global Notes

The regular record date relating to an interest payment date for the notes issued in non-global, registered form will be the date 15 business days prior to the interest payment date, whether or not that interest payment date is a business day; *provided* that for an interest payment date that is also the maturity date, the interest payable on that interest payment date will be payable to the person to whom the principal is payable. If the interest payment date is also a day on which principal is due, the interest payable will include interest accrued to, but excluding, the maturity date. If a note is issued between a record date and an interest payment date, the first interest payment will be made on the next succeeding interest payment date. For the purpose of determining the holder at the close of business on a regular record date, the close of business will mean 5:00 p.m., New York City time, on that day. See "Description of Debt Securities—Legal Ownership; Form of Debt Securities" in the accompanying prospectus.

If a Payment Date Is Not a Business Day

If any scheduled payment date is not a business day, we may pay interest or principal according to a designated business day convention, which may be the same for all of those dates or different for each date. See "Terms of the Notes—Business Day Convention" above. As described under "Terms of the Notes—Payment Dates" above, each payment date will be subject to the "following business day" convention, unless otherwise specified in the applicable pricing supplement.

Interest on that payment may or may not accrue during the period from and after the scheduled or stated payment date. Unless otherwise specified in the applicable pricing supplement, the business day convention is "unadjusted," meaning that if an interest payment date is not a business day, the relevant interest payment will be made on the following or preceding business day in accordance with the designated business day convention with the same effect as if paid on the original due date. Accordingly, the amount of interest accrued and payable on that interest payment date will not be adjusted to reflect the longer or shorter interest period (no additional interest will accrue in the case of payments subject to the following or modified following business day conventions, and no less interest will accrue in the case of payments subject to the preceding business day convention).

If the applicable pricing supplement specifies that the business day convention is "adjusted" and an interest payment date is not a business day, the relevant interest payment will be made on the following or preceding business day in accordance with the designated business day convention and deemed made on the date on which interest is actually paid (and not on the original due date). Accordingly, the amount of interest accrued and payable on that interest payment date will be adjusted to reflect the longer or shorter interest period (additional interest will accrue from and including the original due date to but excluding the postponed interest payment date in the case of payments subject to the following or modified following business day conventions, and no interest will accrue from and including the date on which interest is actually paid in the case of payments subject to the preceding business day convention).

Interest Payment Dates or Coupon Payment Dates

Subject to adjustment in accordance with the business day convention, the "interest payment dates" or "coupon payment dates" are the dates payments of interest on notes will be made. The interest payment dates will be specified in the applicable pricing supplement. See "Terms of the Notes—Interest" and "Interest Mechanics—Regular Record Dates for Interest" in this prospectus supplement and "Description of Debt Securities—Legal Ownership; Form of Debt Securities" in the accompanying prospectus.

How Floating Interest Rates Are Reset

If so specified in the applicable pricing supplement, the interest rate in effect from the date of issue to the first interest reset date for a floating rate note will be the initial interest rate specified in the applicable pricing supplement. We refer to this rate as the "initial interest rate." The interest rate on each floating rate note may be reset daily, weekly, monthly, quarterly, semi-annually, annually or otherwise as specified in the applicable pricing supplement. This period is the "interest reset period." Unless otherwise specified in the applicable pricing supplement, the first day of each interest reset period after the initial interest reset period will be the "interest reset date." If the initial interest rate is not specified in the applicable pricing supplement, the issue date will be treated as the first interest reset date.

Unless otherwise specified in the applicable pricing supplement, if an interest reset date for any floating rate note (other than a note linked to LIBOR, EURIBOR, the federal funds (open) rate or the federal funds (effective) rate) would fall on a day that is not a business day, the interest reset date will be postponed to the next following business day. If an interest reset date for a note linked to LIBOR would fall on a day that is not a London business day (as defined below), the interest reset date will be postponed to the next modified following London business day. If an interest reset date for a note linked to EURIBOR would fall on a day that is not a Euro business day (as defined below), the interest reset date will be postponed to the next modified following Euro business day. If an interest reset date, in the case of a note linked to the federal funds (open) rate or federal funds (effective) rate, would fall on a day that is not a business day, the interest reset date will be postponed to the next modified following business day. If an auction of direct obligations of U.S. Treasury bills falls on a day that is an interest reset date for notes linked to the Treasury rate, the interest reset date will be the next following business day.

As used in this prospectus supplement, a "London business day" means any day that is a Monday, Tuesday, Wednesday, Thursday or Friday and on which dealings in deposits in U.S. dollars are transacted, or with respect to any future date are expected to be transacted, in the London interbank market, and a "Euro business day" means any day that is a Monday, Tuesday, Wednesday, Thursday or Friday on which the Trans-European Automated Real-Time Gross Settlement Express Transfer System (TARGET2), or any successor system, is open for business.

The rate of interest that goes into effect on any interest reset date will be determined by the calculation agent, subject to a rate cut-off (as specified in the relevant pricing supplement), by reference to a particular date called an "interest determination date." Unless otherwise specified in the applicable pricing supplement:

- For notes linked to the federal funds (open) rate, the interest determination date relating to a particular interest reset date will be the same day as the interest reset date.

- For notes linked to the prime rate or federal funds (effective) rate, the interest determination date relating to a particular interest reset date will be the first business day preceding the interest reset date.

- For notes linked to the commercial paper rate, ICE Swap rate or CMT rate, the interest determination date relating to a particular interest reset date will be the second business day preceding the interest reset date.

- For notes linked to LIBOR, the interest determination date will be two London business days prior to the interest reset date.

- For notes linked to EURIBOR, the interest determination date relating to a particular interest reset date will be the second Euro business day preceding the interest reset date.

- For notes linked to the Treasury rate, the interest determination date for a particular interest reset date will be the day of the week in which the interest reset date falls on which Treasury securities would normally be auctioned. Treasury securities are normally sold at auction on Monday of each week unless that day is a legal holiday. In that case the auction is normally held on the following Tuesday, except that the auction may be held on the preceding Friday. If, as the result of a legal holiday, an auction is held on the preceding Friday, that Friday will be the Treasury rate interest determination date pertaining to the interest reset date falling in the next week. If an auction date falls on any day that would otherwise be an interest reset date for a Treasury rate note, then that interest reset date will instead be the business day immediately following the auction date.

- For notes linked to the eleventh district cost of funds rate, the interest determination date relating to a particular interest reset date will be the last working day, in the first calendar month before that interest reset date, on which the Federal Home Loan Bank of San Francisco publishes the monthly average cost of funds paid by a member institutions of the Eleventh Federal Home Loan Bank District for the second calendar month before that interest reset date.

The "index maturity" for any floating rate note is the period of maturity of the instrument or obligation from which the reference asset or base rate is calculated.

TERMS OF THE WARRANTS

General

You should carefully read the general terms and provisions of our debt securities in "Description of Warrants" in the accompanying prospectus. This section supplements that description. The pricing supplement for each offering of warrants will contain the detailed information and terms for that particular offering. The pricing supplement also may add, update or change information contained in any applicable product supplement, any applicable index supplement, this prospectus supplement and the prospectus. If the terms described in the applicable pricing supplement are different from or inconsistent with those described in this prospectus supplement, in the prospectus, in any applicable product supplement or any applicable index supplement, the terms described in the applicable pricing supplement will control. Any pricing supplement should be read in connection with any applicable product supplement, any applicable index supplement, this prospectus supplement and the prospectus. It is important that you consider all of the information in the pricing supplement, any applicable product supplement, any applicable index supplement, this prospectus supplement and the prospectus when making your investment decision.

We will issue warrants under the warrant indenture between us and The Bank of New York Mellon, which acts as trustee, or a warrant agreement between us and the applicable warrant agent. The warrant indenture or warrant agreement, as applicable, permits us to issue different series of warrants from time to time. We may issue warrants in any quantities, at any times and on any terms as we wish. The warrants may differ from one another, and from warrants of other series, in their terms.

The warrants constitute our unsecured and unsubordinated obligations ranking *pari passu*, without any preference among themselves, with all our other outstanding unsecured and unsubordinated obligations, present and future, except those obligations as are preferred by operation of law.

The warrants are not deposit liabilities of Barclays Bank PLC and are not covered by the U.K. Financial Services Compensation Scheme or insured by the FDIC or any other governmental agency or deposit insurance agency of the United States, the United Kingdom or any other jurisdiction.

Please note that the information about the price to the public and net proceeds to Barclays Bank PLC in the applicable pricing supplement relates only to the initial sale of the warrants. If you have purchased the warrants in a purchase/resale transaction after the initial sale, information about the price and date of sale to you will be provided in a separate confirmation of sale.

Type of Warrant

The applicable pricing supplement will specify whether your warrants are call warrants or put warrants, including in each case warrants that may be settled by means of net cash settlement or cashless exercise, or any other type of warrants. Call warrants are warrants that entitle the holder to purchase warrant property at the applicable exercise price or to receive the cash value of the warrant property by paying the applicable exercise price, if any. Put warrants are warrants that entitle the holder to sell warrant property at the applicable exercise price or to receive the cash value of the exercise price by tendering the warrant property or its cash value.

The applicable pricing supplement will also specify whether your warrants will be settled in cash or warrant property, and the method of determining the amount of money or warrant property payable or deliverable upon exercise of your warrants.

Payment or Delivery upon Exercise

The applicable pricing supplement will detail the payment or settlement of the warrants. The payment or delivery of money or warrant property on the payment or settlement date may be based on movements in the level(s), value(s) or price(s) or other events relating to one or more reference assets, and if so, the formula or method of calculation and the relevant reference assets will be specified in the applicable pricing supplement. See "Reference Assets" below for terms of the warrants relating to any reference asset.

Early Redemption at Barclays Bank PLC's Option

The applicable pricing supplement will indicate whether we have the option to redeem the warrants, in whole or in part, on any optional redemption date. If applicable, the redemption price, and any other terms related to our option to redeem the warrants, will be specified in the applicable pricing supplement.

If we exercise any early redemption at our option, we will notify each holder, or in the case of global warrants, the depositary, as holder of the global warrants, within the redemption notice period specified in the applicable pricing supplement. The procedures for early redemption of warrants issued under the warrant indenture are described in the accompanying prospectus under "Description of Warrants—General Provisions of Warrant Indenture—Redemption." The procedures for early redemption of warrants issued under a warrant agreement, if any, will be described in the applicable pricing supplement and warrant agreement.

Payment Dates

The applicable pricing supplement will specify the payment date or settlement date on which amounts or property will or may be payable or deliverable, as applicable, with respect to the warrants. We refer to the payment date or settlement date as a "payment date." Unless otherwise stated in the applicable pricing supplement, each payment date will be governed by the "following business day" convention (*i.e.*, if the applicable payment date stated in the applicable pricing supplement is not a business day, that payment date will be extended to the next following business day).

If the final valuation date is postponed, the payment date will be postponed by the same number of business days from but excluding the originally scheduled final valuation date to and including the actual final valuation date.

If the warrants are linked to a basket of multiple assets or to the best or worst performing in a group of reference assets (in either case, other than a basket or a group of reference assets containing only equity securities, exchange-traded funds and/or indices of equity securities), the valuation date or final valuation date, for purposes of the preceding paragraph, will be deemed to have occurred on the earliest date on which the levels, values or prices for the all basket components or reference assets, as applicable, have been determined.

Unless otherwise specified in the applicable pricing supplement, in the event that a payment date is extended or postponed as described above, any amounts payable or property deliverable on the warrants on that payment date will be made, without additional interest, on the postponed payment date.

Valuation Dates, Review Dates, Determination Dates, Observation Dates and Averaging Dates

We refer to each date on which the level, value or price of any reference asset is to be referenced in the determination of any payment (whether in cash or property) on the warrants as a "valuation date." The applicable pricing supplement may also refer to a valuation date as an "observation date," a "review date," a "determination date" or an "averaging date." We refer to the date on which the warrants are initially priced for sale to the public as the "initial valuation date," and such date will, unless otherwise set forth in the applicable pricing supplement, be the date on which the initial level, initial value or initial price of a reference asset is established. We refer to the valuation date on which the final level, final value or final price of a reference asset is established as the "final valuation date." For the avoidance of doubt, if the final level, final value or final price of a reference asset is based on the levels, values, or prices of that reference asset on multiple valuation dates (either consecutively near the end of the term of the notes or periodically throughout the term of the notes), the last of those valuation dates will be the "final valuation date."

Each valuation date will be specified in the applicable pricing supplement, *provided* that the calculation agent may postpone any valuation date if the calculation agent determines that the originally scheduled valuation date is not a scheduled trading day or that a market disruption event has occurred or is continuing on a day that would otherwise be that valuation date. We describe market disruption events and valuation date postponement for the various reference assets under "Reference Assets" below.

Exercise Dates or Exercise Periods

The applicable pricing supplement may specify any exercise date or exercise period preceding the payment date on which the holder of the warrant may exercise their warrants. Unless otherwise stated in the applicable pricing supplement, exercise date (or, in the case of an exercise period, each relevant date during the exercise period) will be governed by the "following business day" convention (*i.e.*, if an exercise date stated in the applicable pricing supplement is not a business day, that exercise date will be extended to the next following business day).

Business Day

As used in this prospectus supplement, and in the applicable pricing supplement unless otherwise defined therein, "business day" means any day that is a Monday, Tuesday, Wednesday, Thursday or Friday and that is not a day on which banking institutions in New York City generally are authorized or obligated by law, regulation or executive order to be closed.

Business Day Convention

Business day conventions are procedures used to adjust certain events (*e.g.*, payment or settlement dates and redemption dates) that fall on days that are not business days. Unless the applicable pricing supplement states otherwise, those events will be governed by the "following business day" convention (*e.g.*, if a payment or settlement date, redemption date or other event, as defined in the applicable pricing supplement, falls on a day that is not a business day, the payment or settlement date, redemption date or other event, as the case may be, will be the next following business day). As described under "Terms of the Warrants—Payment Dates" above, each payment date will be subject to the "following business day" convention, unless otherwise specified in the applicable pricing supplement.

Following Business Day. Any payment of money or delivery of warrant property on the warrants that would otherwise be due on a day that is not a business day will instead be paid or delivered on the next day that is a business day.

Modified Following Business Day. Any payment of money or delivery of warrant property in respect of the warrants that would otherwise be due on a day that is not a business day will instead be paid or delivered on the next day that is a business day, unless that day falls in the next calendar month, in which case the payment or delivery date will be the first preceding day that is a business day.

Preceding Business Day. Any payment of money or delivery of warrant property in respect of the warrants that would otherwise be due on a day that is not a business day will instead be paid or delivered on the first preceding day that is a business day.

Nearest Business Day. Any payment of money or delivery of warrant property in respect of the warrants that would otherwise be due on a day that is not a business day will instead be paid on the first preceding day that is a business day if the originally scheduled payment date would otherwise fall on a day other than a Sunday or a Monday and will be paid on the next day that is a business day if the originally scheduled payment date would otherwise fall on a Sunday or a Monday.

In each case, if a payment of money or a delivery of warrant property is made on the following or preceding business day in accordance with the procedures described above with the same effect as if paid or delivered on the original due date and without payment or delivery of any additional money or warrant property, the business day convention is "unadjusted."

Payment and Paying Agent or Warrant Agent

Currency of Warrants

Amounts that become due and payable on your warrants in cash will be payable in a currency, composite currency, basket of currencies or currency unit or units ("specified currencies") specified in the applicable pricing supplement. The specified currency for your warrants will be U.S. dollars, unless your pricing supplement states otherwise. We will make payments on your warrants in the specified currency, except as described in the applicable pricing supplement. See "Risk Factors—Additional Risks Relating to Securities Payable in a Currency Other Than U.S. Dollars" in this prospectus supplement for more information about the risks of investing in this kind of warrant. The procedures for non-cash settlement of warrants, if applicable, will be described in the applicable pricing supplement.

Payments Due in U.S. Dollars

We will follow the practices described below when paying amounts due in U.S. dollars.

Payments on Global Warrants. We will make payments on a global warrant in accordance with the applicable policies of the depositary as in effect from time to time. Under those policies, we will pay directly to the depositary, or its nominee, and not to any indirect owners who own beneficial interests in the global warrant. An indirect owner's right to receive those payments will be governed by the rules and practices of the depositary and its participants, as described in the section entitled "Description of Warrants—Legal Ownership; Form of Warrants" in the accompanying prospectus.

Payments on Non-Global Warrants. We will make payments on a warrant in non-global, registered form as follows. We will make all payments by check at the paying agent or at the office of the warrant agent, as applicable and described below, against surrender of the warrant. All payments by check will be made in next-day funds—i.e., funds that become available on the day after the check is cashed. Alternatively, if a non-global warrant has an original issue price of at least $1,000,000 and the holder asks us to do so, we will pay any amount that becomes due on the warrant by wire transfer of immediately available funds to an account at a bank in New York City, on the due date. To request wire payment, the holder must give the paying agent or warrant agent, as applicable, appropriate wire transfer instructions at least five business days before the requested wire payment is due. In the case of any other payment, payment will be made only after the warrant is surrendered to the paying agent or warrant agent. Any wire instructions, once properly given, will remain in effect unless and until new instructions are given in the manner described above.

Book-entry and other indirect owners should consult their banks or brokers for information on how they will receive payments due on their warrants.

For a description of the paying agent and warrant agent, see "Description of Warrants—General Provisions of Warrant Indenture—Payment and Paying Agents" and "Description of Warrants—General Provisions of Warrant Agreements—Payments" in the accompanying prospectus.

Payments Due in Non-U.S. Dollar Currencies

We will follow the practices described below when paying amounts that are due in a specified currency other than U.S. dollars.

Payments on Global Warrants. We will make payments on a global warrant in accordance with the applicable policies of the depositary as in effect from time to time. Unless we say otherwise in the applicable pricing supplement, DTC will be the depositary for all warrants in global form.

Book-entry and other indirect holders of a global warrant payable in a currency other than U.S. dollars should consult their banks or brokers for information on how to request payment in the specified currency.

Payments on Non-Global Warrants. Except where otherwise requested by the holder as described below, we will make payments on warrants in non-global form in the applicable specified currency. We will make these payments by wire transfer of immediately available funds to any account that is maintained in the applicable specified currency at a bank designated by the holder and that is acceptable to us and the trustee or warrant agent, as applicable. To designate an account for wire payment, the holder must give the paying agent or warrant agent, as applicable, appropriate wire instructions at least five business days before the requested wire payment is due. Payment will be made only after the warrant is surrendered to the paying agent or warrant agent. Any instructions, once properly given, will remain in effect unless and until new instructions are properly given in the manner described above.

If a holder fails to give instructions as described above, we will notify the holder at the address in the records of the trustee or warrant agent, as applicable, and will make the payment within five business days after the holder provides appropriate instructions. Any late payment made in these circumstances will be treated under the warrant indenture or warrant agreement, as applicable, as if made on the due date, and no interest will accrue on the late payment from the due date to the date paid.

Although a payment on a warrant in non-global form may be due in a specified currency other than U.S. dollars, we will make the payment in U.S. dollars if the holder asks us to do so. To request U.S. dollar payment, the holder must provide appropriate written notice to the paying agent or warrant agent, as applicable, at least five business days before the due date for which payment in U.S. dollars is requested. Any request, once properly made, will remain in effect unless and until revoked by notice properly given in the manner described above.

Indirect owners of a non-global warrant with a specified currency other than U.S. dollars should contact their banks or brokers for information about how to receive payments in the specified currency or in U.S. dollars.

Conversion to U.S. Dollars. When we make payments in U.S. dollars of an amount due in another currency, either on a global warrant or a non-global warrant as described above, we will determine the U.S. dollar amount the holder receives as follows. The exchange rate agent described below will request currency bid quotations expressed in U.S. dollars from three or, if three are not available, then two, recognized foreign exchange dealers in New York City, any of which may be the exchange rate agent, which may be Barclays Capital Inc., an affiliate of Barclays Bank PLC, as of 11:00 a.m., New York City time, on the second business day before the payment date.

Currency bid quotations will be requested on an aggregate basis, for all holders of warrants requesting U.S. dollar payments of amounts due on the same date in the same specified currency. The U.S. dollar amount the holder receives will be based on the highest acceptable currency bid quotation received by the exchange rate agent. If the exchange rate agent determines that at least two acceptable currency bid quotations are not available on that second business day, the payment will be made in the specified currency.

To be acceptable, a quotation must be given as of 11:00 a.m., New York City time, on the second business day before the due date and the quoting dealer must commit to execute a contract at the quotation in the total amount due in that currency on all series of warrants.

When we make payments to you in U.S. dollars of an amount due in another currency, you will bear all associated currency exchange costs, which will be deducted from the payment.

When the Specified Currency Is Not Available. If we are obligated to make any payment in a specified currency other than U.S. dollars, and the specified currency or any successor currency is not available to us or cannot be paid to you due to circumstances beyond our control—such as the imposition of exchange controls or a disruption in the currency markets—we will be entitled to satisfy our obligation to make the payment in that specified currency by making the payment in U.S. dollars, on the basis specified in the applicable pricing supplement.

The foregoing will apply to any cash-settled warrant, whether in global or non-global form, and to any payment, including a payment at the payment or settlement date. Any payment made under the circumstances and in a manner described above will not result in a default under any warrant or the warrant indenture or warrant agreement, as applicable.

Exchange Rate Agent. If we issue a warrant in a specified currency other than U.S. dollars, we will appoint a financial institution to act as the exchange rate agent and will name the institution initially appointed when the warrant is originally issued in the applicable pricing supplement. We may select Barclays Capital Inc. or another of our affiliates to perform this role. We may change the exchange rate agent from time to time after the original issue date of the warrant without your consent and without notifying you of the change.

All determinations made by the exchange rate agent will be at its sole discretion unless we state in your pricing supplement that any determination is subject to our approval. In the absence of manifest error, those determinations will be conclusive for all purposes and final and binding on you and us, without any liability on the part of the exchange rate agent.

Calculations and Calculation Agent

Any calculations relating to the warrants will be made by the calculation agent, an institution that we appoint as our agent for this purpose. Unless otherwise specified in the applicable pricing supplement, Barclays Bank PLC will act as calculation agent. We may appoint a different institution, including one of our affiliates, to serve as calculation agent from time to time after the original issue date of the warrant without your consent and without notifying you of the change. We will ensure that there is a financial institution serving as the calculation agent at all relevant times.

The calculation agent will, in its sole discretion, make all determinations regarding any amounts payable or property deliverable in respect of your warrants, the level(s), value(s) or price(s) of the reference asset(s), market disruption events, early redemption events, business days, the default amount (only in the case of an event of default under the warrant indenture), the relevant exercise date or period, optional redemption dates, if any, and any other calculations or determinations to be made by the calculation agent. Absent manifest error, all determinations of the calculation agent will be conclusive for all purposes and final and binding on you and us, without any liability on the part of the calculation agent.

The calculation agent is obligated to carry out its duties and functions as calculation agent in good faith and using reasonable judgment. However, in engaging in these activities the calculation agent will have no obligation to consider your interests as an investor in the warrants, and if the calculation agent is Barclays Bank PLC or one of our affiliates, in making these discretionary judgments, it may have economic interests that are adverse to your interests as an investor in the notes and its determinations may adversely affect the value of and any return on your warrants. You will not be entitled to any compensation from us for any loss suffered as a result of any of the above determinations by the calculation agent.

All percentages resulting from any calculation relating to a warrant will, unless otherwise specified in the applicable pricing supplement, be rounded upward or downward, as appropriate, to the next higher or lower one hundred-thousandth of a percentage point, e.g., 9.876544% (or .09876544) being rounded down to 9.87654% (or .0987654) and 9.876545% (or .09876545) being rounded up to 9.87655% (or .0987655). All amounts used in or resulting from any calculation relating to a warrant will, unless otherwise specified in the applicable pricing supplement, be rounded upward or downward, as appropriate, to the nearest cent, in the case of U.S. dollars, the nearest corresponding hundredth of a unit, in the case of a currency other than U.S. dollars, or to the nearest one hundred-thousandth of a unit, in the case of a currency exchange rate, with one-half cent, one-half of a corresponding hundredth of a unit or one-half of a hundred-thousandth of a unit or more being rounded upward.

In determining the level, value or price of a reference asset that applies to a warrant during a particular period, the calculation agent may obtain quotes from various banks or dealers active in the relevant market, as described under "Reference Assets" below. Those reference banks, dealers, reference asset sponsors or information providers may include the calculation agent itself and its affiliates, as well as any underwriter, dealer or agent participating in the distribution of the relevant warrants and its affiliates, and they may include Barclays Bank PLC or its affiliates.

Default Amount

If an event of default occurs in respect of warrants issued under the warrant indenture, we may be required to pay a default amount in respect of the warrants.

Determination of Default Amount

The default amount for the warrants on any day will be an amount, determined by the calculation agent in its sole discretion, that is equal to the cost of having a qualified financial institution, of the kind and selected as described below, expressly assume all our payment and other obligations, if any, with respect to the warrants as of that day and as if no default had occurred, or to undertake other obligations providing substantially equivalent economic value to you with respect to the warrants. That cost will equal:

- the lowest amount that a qualified financial institution would charge to effect this assumption or undertaking, plus
- the reasonable expenses, including reasonable attorneys' fees, incurred by the holders of the warrants in preparing any documentation necessary for this assumption or undertaking.

During the default quotation period for the warrants, which we describe below, the holders of the warrants and/or we may request a qualified financial institution to provide a quotation of the amount it would charge to effect this assumption or undertaking. If either party obtains a quotation, it must notify the other party in writing of the quotation. The amount referred to in the first bullet point above will equal the lowest—or, if there is only one, the only—quotation obtained, and as to which notice is so given, during the default quotation period. With respect to any quotation, however, the party not obtaining the quotation may object, on reasonable and significant grounds, to the assumption or undertaking by the qualified financial institution providing the quotation and notify the other party in writing of those grounds within two business days after the last day of the default quotation period, in which case that quotation will be disregarded in determining the default amount.

Default Quotation Period

The default quotation period is the period beginning on the day the default amount first becomes due and ending on the third business day after that day, unless:

- no quotation of the kind referred to above is obtained, or
- every quotation of that kind obtained is objected to within five business days after the due date as described above.

If either of these two events occurs, the default quotation period will continue until the third business day after the first business day on which prompt notice of a quotation is given as described above. If that quotation is objected to as described above within five business days after that first business day, however, the default quotation period will continue as described in the prior sentence and this sentence.

In any event, if the default quotation period and the subsequent two business day objection period have not ended before the final valuation date, then the default amount will be equal to the issue price.

Qualified Financial Institutions

For the purpose of determining the default amount at any time, a qualified financial institution must be a financial institution organized under the laws of any jurisdiction in the United States or Europe, which at that time has outstanding debt obligations with a stated maturity of one year or less from the date of issue and rated either:

- A-1 or higher by Standard & Poor's Ratings Services or any successor, or any other comparable rating then used by that rating agency, or
- P-1 or higher by Moody's Investors Service or any successor, or any other comparable rating then used by that rating agency.

REFERENCE ASSETS

Fixed Interest Rate

If the notes have a fixed interest rate, the notes will bear interest from and including the original issue date or any other date specified in the applicable pricing supplement at the annual rate stated in the applicable pricing supplement until the principal is paid or made available for payment, unless otherwise specified in the applicable pricing supplement.

Floating Interest Rate

If the notes have a floating interest rate, the notes will bear interest at a floating rate determined by reference to an interest rate or interest rate formula, which we refer to as the "reference asset." In addition, if so specified in the relevant pricing supplement, the payment at maturity for notes that are linked to a floating interest rate may be based on the level of an interest rate or interest rate formula on one or more interest determination dates. The reference asset may be one or more of the following:

- the ICE Swap rate,
- the CMT rate,
- the commercial paper rate,
- the Consumer Price Index,
- the eleventh district cost of funds rate,
- EURIBOR,
- the federal funds (effective) rate,
- the federal funds (open) rate,
- LIBOR,
- the prime rate,
- the Treasury rate,
- a combination of any of the above, or
- any other rate or interest rate formula specified in the applicable pricing supplement and in the floating rate note.

We have no current intention to offer warrants linked to the reference assets listed above due to regulatory restrictions, and we may also limit the percentage of those reference assets included in a basket underlying a warrant in order to comply with regulatory restrictions, where applicable. However, if we offer warrants linked to any of the above as a reference asset or within a basket of multiple instruments or measures in a manner that complies with any applicable regulatory restrictions, the relevant pricing supplement will describe the interest rate or inflation-related component and its role in the formula or method of calculation to determine the amount of money payable upon exercise, as well as the relevant valuation date.

ICE Swap Rate

The "ICE Swap Rate" means, for any interest determination date, the rate for U.S. dollar swaps, expressed as a percentage, with a maturity for a number of years specified in the applicable pricing supplement, which appears on Reuters page "ICESWAP1" (or such other page as may replace that page on that service) as of 11:00 a.m., New York City time, on that interest determination date. An ICE Swap Rate is also sometimes referred to as a "constant-maturity swap rate" or a "CMS rate."

The following procedures will be used if the ICE Swap rate cannot be determined as described above:

- If the above rate is no longer displayed on the relevant page, or if not displayed by approximately 11:00 a.m., New York City time, on the interest determination date, then the ICE Swap rate will be a percentage determined on the basis of the mid-market, semi-annual swap rate quotations provided by five leading swap dealers in the New York City interbank market at approximately 11:00 a.m., New York City time, on the interest determination date. For this purpose, the semi-annual swap rate means the mean of the bid and offered rates for the semi-annual fixed leg, calculated on a 30/360 day count basis, of a fixed-for-floating U.S. dollar interest rate swap transaction with a term equal to the designated maturity of the applicable ICE Swap rate as specified in the relevant pricing supplement commencing on that interest determination date with an acknowledged dealer of good credit in the swap market, where the floating leg, calculated on an Actual/360 day count basis, is equivalent to Three-month LIBOR (as defined below). The calculation agent will select the five swap dealers after consultation with us and will request the principal New York City office of each of those dealers to provide a quotation of its rate. If at least three quotations are provided, the ICE Swap rate for that interest determination date will be the arithmetic mean of the quotations, eliminating the highest quotation (or, in the event of equality, one of the highest) and the lowest quotation (or, in the event of equality, one of the lowest).

- If fewer than three leading swap dealers selected by the calculation agent provide quotes as described above, the ICE Swap rate will be determined by the calculation agent in its sole discretion.

CMT Rate

CMT rates are yields interpolated by the United States Department of the Treasury from its daily yield curve. That yield curve, which relates to the yield on a U.S. Treasury security to its time to maturity, is based on the closing market bid yields on actively traded U.S. Treasury securities in the over-the-counter market. These market yields are calculated from composites of quotations obtained by the Federal Reserve Bank of New York. The yield values are read from the yield curve at fixed maturities. This method provides yields for a two-year maturity, for example, even if no outstanding U.S. Treasury security has exactly two years remaining to maturity.

The "CMT rate," for any interest determination date, will be a percentage equal to the yield for United States Treasury securities at "constant maturity" with a designated maturity of a specified number of years, as set forth in H.15(519) (as defined below), under the caption "Treasury constant maturities," as that rate is displayed on the Designated CMT page (as defined below) on that interest determination date.

"U.S. government securities business days" means any day except for a Saturday, Sunday or a day on which The Securities Industry and Financial Markets Association (formerly known as The Bond Market Association) (or any successor or replacement organization) recommends that the fixed income departments of its members be closed for the entire day for purposes of trading in U.S. government securities.

"1-year CMT rate" means the USD-CMT-T7051 rate with a designated maturity of one year.

"2-year CMT rate" means the USD-CMT-T7051 rate with a designated maturity of two years.

"3-year CMT rate" means the USD-CMT-T7051 rate with a designated maturity of three years.

"5-year CMT rate" means the USD-CMT-T7051 rate with a designated maturity of five years.

"7-year CMT rate" means the USD-CMT-T7051 rate with a designated maturity of seven years.

"10-year CMT rate" means the USD-CMT-T7051 rate with a designated maturity of ten years.

"20-year CMT rate" means the USD-CMT-T7051 rate with a designated maturity of 20 years.

"30-year CMT rate" means the USD-CMT-T7051 rate with a designated maturity of 30 years.

The following procedures will be followed if the CMT rate cannot be determined as described above:

- If the CMT rate is not displayed on the relevant page by 3:30 p.m., New York City time on the interest determination date, then the CMT rate will be a percentage equal to the yield for U.S. Treasury securities at "constant maturity" for the Designated CMT Maturity Index on the interest determination date as set forth in H.15(519) opposite the caption "Treasury constant maturities."

- If the applicable rate described above does not so appear in H.15(519) then the CMT rate on the interest determination date will be the rate for the Designated CMT Maturity Index as may then be published by either the Board of Governors of the Federal Reserve System (the "Board") or the U.S. Department of the Treasury that the calculation agent determines to be comparable to the rate formerly displayed on the Designated CMT page and published in the relevant H.15(519).

- If on the interest determination date, neither the Board nor the U.S. Department of the Treasury publishes a yield on U.S. Treasury securities at a "constant maturity" for the Designated CMT Maturity Index, the CMT rate on the interest determination date will be calculated by the calculation agent and will be a yield-to-maturity based on the arithmetic mean of the secondary market bid prices at approximately 3:30 p.m., New York City time, on the interest determination date, of three leading primary U.S. government securities dealers in New York City. The calculation agent will select five such securities dealers, and will eliminate the highest quotation (or, in the event of equality, one of the highest) and the lowest quotation (or, in the event of equality, one of the lowest), for U.S. Treasury securities with an original maturity equal to the Designated CMT Maturity Index, a remaining term to maturity of no more than one year shorter than that Designated CMT Maturity Index and in a principal amount equal to the Representative Amount. If two bid prices with an original maturity as described above have remaining terms to maturity equally close to the Designated CMT Maturity Index, the quotes for the U.S. Treasury security with the shorter remaining term to maturity will be used. The "Representative Amount" means an amount equal to the outstanding principal amount of the notes.

- If fewer than five but more than two such prices are provided as requested, the CMT rate for the interest determination date will be based on the arithmetic mean of the bid prices obtained and neither the highest nor the lowest of those quotations will be eliminated.

- If fewer than three leading primary U.S. government securities dealers selected by the calculation agent provide quotes as described above, the CMT rate will be determined by the calculation agent in its sole discretion after consulting such sources as it deems comparable to any of the foregoing quotations or display pages, or any such source it deems reasonable from which to estimate the rate for U.S. Treasury securities at constant maturity or any of the foregoing bid rates.

"Designated CMT page" means the display on the Reuters service, or any successor service, on the page designated in the applicable pricing supplement or any other page as may replace that page on that service for the purpose of displaying Treasury Constant Maturities as reported in H.15(519). If no page is specified in the applicable pricing supplement the Designated CMT page will be the Reuters screen "FRBCMT" page on the relevant interest determination date.

"H.15(519)" means the weekly statistical release designated as such, or any successor publication, published by the Board, available through the website of the Board at http://www.federalreserve.gov/releases/H15/ or any successor site or publication. We make no representation or warranty as to the accuracy or completeness of the information displayed on that website, and that information is not incorporated by reference herein and should not be considered a part of this prospectus supplement.

"Designated CMT Maturity Index" means the original period to maturity of the U.S. Treasury securities, which is either one, two, three, five, seven, ten, 20 or 30 years, specified in the applicable pricing supplement for which the CMT rate will be calculated. If no maturity is specified in the applicable pricing supplement the Designated CMT Maturity Index will be two years.

Commercial Paper Rate

The "commercial paper rate" means, for any interest determination date, the money market yield, calculated as described below, of the rate on that interest determination date for commercial paper having the index maturity specified in the applicable pricing supplement, as that rate is published in H.15(519), under the heading "Commercial Paper—Nonfinancial."

The following procedures will be followed if the commercial paper rate cannot be determined as described above:

- If the above rate is not published by 3:00 p.m., New York City time, on the interest determination date, then the commercial paper rate will be the money market yield of the rate on that interest determination date for commercial paper of the index maturity specified in the applicable pricing supplement as published in the H.15 Daily Update, or other recognized electronic source used for the purpose of displaying the applicable rate, under the heading "Commercial Paper—Nonfinancial."

- If by 3:00 p.m., New York City time, on that interest determination date the rate is not yet published in either H.15(519) or the H.15 Daily Update, then the calculation agent will determine the commercial paper rate to be the money market yield of the arithmetic mean of the offered rates as of 11:00 a.m., New York City time, on that interest determination date of three leading dealers of U.S. dollar commercial paper in New York City, which may include the agent and its affiliates, selected by the calculation agent, after consultation with us, for commercial paper of the index maturity specified in the applicable pricing supplement, placed for an industrial issuer whose bond rating is "AA," or the equivalent, from a nationally recognized statistical rating agency.

- If fewer than three leading dealers of U.S. dollar commercial paper in New York City selected by the calculation agent are quoting as set forth above, the commercial paper rate will be the money market yield of the rate for commercial paper (having the index maturity specified in the applicable pricing supplement) for the first day immediately preceding the relevant interest determination date for which that rate was published in H.15(519), under the heading "Commercial Paper—Nonfinancial," or, if later, the first day immediately preceding the relevant interest determination date for which that rate was published in either H.15 Daily Update or another recognized electronic source.

The "money market yield" will be a yield calculated in accordance with the following formula:

$$\text{money market yield} = \frac{(\mathrm{D} \times 360)}{360 - (\mathrm{D} \times \mathrm{M})} \times 100$$

where "D" refers to the applicable per-year rate for commercial paper quoted on a bank discount basis and expressed as a decimal and "M" refers to the actual number of days in the interest reset period for which interest is being calculated.

Consumer Price Index

The "Consumer Price Index" or "CPI" means the non-seasonally adjusted U.S. City Average All Items Consumer Price Index for All Urban Consumers, published monthly by the Bureau of Labor Statistics of the U.S. Department of Labor (the "Bureau of Labor Statistics") and reported on Bloomberg ticker "CPURNSA" or any successor service ("Bloomberg CPURNSA"). The Bureau of Labor Statistics makes the majority of its consumer price index data and press releases publicly available immediately at the time of release. This material may be accessed electronically by means of the Bureau of Labor Statistics' home page on the Internet at http://www.bls.gov. We make no representation or warranty as to the accuracy or completeness of the information displayed on that website, and that information is not incorporated by reference herein and should not be considered a part of this prospectus supplement. The Consumer Price Index for a particular month is published during the following month. The Consumer Price Index is a measure of the average change in consumer prices over time for a fixed market basket of goods and services, including food, clothing, shelter, fuels, transportation, charges for doctors and dentists services, and drugs. User fees (such as water and sewer service) and sales and excise taxes paid by the consumer are included in determining consumer prices. Income taxes and investment items such as stocks, bonds and life insurance are not included. The Consumer Price Index includes expenditures by urban wage earners and clerical

workers, professional, managerial and technical workers, the self-employed, short-term workers, the unemployed, retirees and others not in the labor force. In calculating the Consumer Price Index, price changes for the various items are averaged together with weights that represent their importance in the spending of urban households in the United States. The contents of the market basket of goods and services and the weights assigned to the various items are updated periodically by the Bureau of Labor Statistics to take into account changes in consumer expenditure patterns.

The Consumer Price Index is expressed in relative terms in relation to a time base reference period for which the level is set at 100.0. The time base reference period is the 1982-1984 average. Because the Consumer Price Index for the period from 1982-1984 is 100, an increase in the price of the fixed market basket of goods and services of 16.5% from that period would be shown as 116.5. If the Bureau of Labor Statistics rebases the Consumer Price Index when the notes are outstanding, the calculation agent will continue to calculate inflation using 1982-1984 as the base reference period for so long as the current Consumer Price Index continues to be published. Any conversion by the Bureau of Labor Statistics to a new reference base will not affect the measurement of the percent changes in a given index series from one time period to another, except for rounding differences. Rebasing might affect the published "headline" number often quoted in the financial press, but the inflation calculation for the notes should not be adversely affected by any rebasing because the Consumer Price Index based on 1982-1984 will be calculated using the percentage changes of the rebased Consumer Price Index.

The Bureau of Labor Statistics has made technical and methodological changes to the Consumer Price Index, and is likely to continue to do so. Examples of recent methodological changes include:

- the use of regression models to adjust for improvements in the quality of various goods (televisions, personal computers, etc.);
- the introduction of geometric averages to account for consumer substitution within the consumer price index categories; and
- changing the housing/shelter formula to increase rental equivalence estimation.

Similar changes in the future could affect the level of the Consumer Price Index and alter the interest payable on the notes.

For each interest payment date, "CPI Performance" is equal to the annual percentage change in the CPI (as calculated by the Bureau of Labor Statistics) for the period up to and including the stated calendar month prior to the month of the relevant interest payment date (the "reference month").

For example, if the reference month is specified as the third calendar month prior to the month of the relevant interest payment date, then for an interest payment date in June of any year, the reference month would be March, and the amount of interest paid on the interest payment date in June would be calculated using a CPI Performance that reflects the annual percentage change in the CPI from March of the prior year to March of the year in which the interest payment date occurs.

The performance of the Consumer Price Index will be calculated as follows:

$$\text{Interest Rate} = \frac{\text{CPI}_\text{F} - \text{CPI}_\text{I}}{\text{CPI}_\text{I}}$$

where,

CPI_F = CPI for the applicable reference month, as published on Bloomberg CPURNSA; and

CPI_I = CPI for the twelfth month, or otherwise as specified in the applicable pricing supplement, prior to the applicable reference month, as published on Bloomberg CPURNSA.

Using the example above, if CPI Performance for the second calendar month prior to the relevant interest payment date was used, then the interest rate payable on September 30, 2014 will reflect the percentage change in the Consumer Price Index from July 2013 to July 2014 plus the applicable spread, if any.

The interest payment on any interest payment date will not be less than 0.00% per annum, unless specified in the applicable pricing supplement.

The following procedures will be followed if the Consumer Price Index cannot be determined as described above:

- If the Consumer Price Index is not reported on Bloomberg CPURNSA for a particular month by 3:00 p.m., New York City time, on the interest determination date, but has otherwise been published by the Bureau of Labor Statistics, the calculation agent will determine the Consumer Price Index as published by the Bureau of Labor Statistics for that month using any other source as the calculation agent deems appropriate.

- If the Consumer Price Index is rebased to a different year or period, the base reference period will continue to be the 1982-1984 reference period as long as the 1982-1984 Consumer Price Index continues to be published.

- If the Consumer Price Index for the reference month is subsequently revised by the Bureau of Labor Statistics, the calculation agent will continue to use the Consumer Price Index initially published by the Bureau of Labor Statistics on or before the interest determination date.

- If the Consumer Price Index is discontinued or substantially altered, as determined by the calculation agent, the applicable substitute index for the notes will be that chosen by the Secretary of the Treasury for the Department of Treasury's Inflation-Linked Treasuries as described at 62 Federal Register 846-874 (January 6, 1997). If none of Treasury's Inflation-Linked Treasuries are outstanding, the calculation agent will determine a substitute index for the notes in accordance with general market practice at the time.

Eleventh District Cost of Funds

The "eleventh district cost of funds rate" or "COFI" means, for any interest determination date, the rate on the applicable interest determination date equal to the monthly weighted average cost of funds for the calendar month preceding the interest determination date as displayed under the caption "Eleventh District" or "11th Dist COFI" on the Reuters screen "COFI/ARMS" page.

The following procedures will be followed if the eleventh district cost of funds rate cannot be determined as described above:

- If the above rate is not displayed by 3:00 p.m., New York City time, on the applicable interest determination date, the eleventh district cost of funds rate for the applicable interest determination date will be the eleventh district cost of funds rate index on the applicable interest determination date.

- If the Federal Home Loan Bank of San Francisco fails to announce the rate for the calendar month preceding the applicable interest determination date, then the eleventh district cost of funds rate for the applicable interest determination date will be the rate displayed under "Eleventh District" or "11th Dist COFI" on the Reuters screen "COFI/ARMS" page equal to the monthly weighted average cost of funds for the calendar month preceding the last day on which that rate was displayed under "Eleventh District" or "11th Dist COFI" on the Reuters screen "COFI/ARMS" page.

The "eleventh district cost of funds rate index" means the monthly weighted average cost of funds paid by member institutions of the Eleventh Federal Home Loan Bank District that the Federal Home Loan Bank of San Francisco most recently announced as the cost of funds for the calendar month preceding the date of the announcement.

EURIBOR

The Euro Interbank Offered Rate ("EURIBOR") means, for any interest determination date, the rate for deposits in euros as sponsored, calculated and published jointly by the European Banking Federation and ACI—The Financial Market Association, or any company established by the joint sponsors for purposes of compiling and publishing those rates, for the index maturity specified in the applicable pricing supplement as that rate appears on the display on the Reuters screen "EURIBOR01" page as of 11:00 a.m., Brussels time on that determination date.

The following procedures will be followed if the rate cannot be determined as described above:

- If the above rate does not appear, the calculation agent will request the principal Euro-zone office of each of four major banks in the Euro-zone interbank market, as selected by the calculation agent, after consultation with us, to provide the calculation agent with its offered rate for deposits in euros, at approximately 11:00 a.m., Brussels time, on the interest determination date, to prime banks in the Euro-zone interbank market for the index maturity specified in the applicable pricing supplement commencing on the applicable interest reset date, and in a principal amount not less than the equivalent of US$1 million in euros that is representative of a single transaction in euros, in that market at that time. If at least two quotations are provided, EURIBOR will be the arithmetic mean of those quotations.

- If fewer than two quotations are provided, EURIBOR will be the arithmetic mean of the rates quoted by four major banks in the Euro-zone interbank market, as selected by the calculation agent, after consultation with us, at approximately 11:00 a.m., Brussels time, on the applicable interest reset date for loans in euros to leading European banks for a period of time equivalent to the index maturity specified in the applicable pricing supplement commencing on that interest reset date in a principal amount not less than the equivalent of US$1 million in euros that is representative of a single transaction in euros, in that market at that time.

- If fewer than four major banks in the Euro-zone interbank market selected by the calculation agent provide quotes as set forth above, EURIBOR for that interest determination date will be the rate (with the applicable index maturity) for deposits in euros as sponsored, calculated and published jointly by the European Banking Federation and ACI—The Financial Market Association, or any company established by the joint sponsors for purposes of compiling and publishing those rates, in effect for the first day immediately preceding the relevant interest determination date for which that rate (with the applicable index maturity) appeared on the Reuters screen "EURIBOR01" page.

"Euro-zone" means the region comprising member states of the European Union that have adopted the single currency in accordance with the relevant treaty of the European Union, as amended.

Federal Funds (Effective) Rate

The "federal funds (effective) rate" means, for any interest determination date, the rate on that date for federal funds as published in H.15(519) under the heading "Federal Funds (effective)" as displayed on the Reuters screen "FEDFUNDS1" page.

The following procedures will be followed if the federal funds (effective) rate cannot be determined as described above:

- If the above rate is not published by 3:00 p.m., New York City time, on the interest determination date, the federal funds (effective) rate will be the rate on that interest determination date as published in the H.15 Daily Update, or other recognized electronic source used for the purpose of displaying the applicable rate, under the heading "Federal Funds/Effective Rate."

- If the above rate is not yet published in either H.15(519) or the H.15 Daily Update by 3:00 p.m., New York City time, on the interest determination date, the calculation agent will determine the federal funds (effective) rate to be the arithmetic mean of the rates for the last transaction in overnight U.S. dollar federal funds by each of three leading brokers of U.S. dollar federal funds transactions in New York City, which may include the agent and its affiliates, selected by the calculation agent, after consultation with us, prior to 9:00 a.m., New York City time, on that interest determination date.

- If fewer than three leading brokers of U.S. dollar federal funds transactions in New York City selected by the calculation agent are quoting as set forth above, the federal funds rate for the interest determination date will be the federal funds (effective) rate for the first day immediately preceding that interest determination date for which that rate is published in H.15(519) under the heading "Federal funds (effective)," or, if later, the first day immediately preceding the relevant interest determination date for which that rate was published in either H.15 Daily Update or another recognized electronic source.

Federal Funds (Open) Rate

The "federal funds (open) rate" means, for any interest determination date, the rate on that date for federal funds as published in H.15(519) under the section "Federal Funds" next to the caption "OPEN," as displayed on the Reuters screen "5" page.

The following procedures will be followed if the federal funds (open) rate cannot be determined as described above:

- If the above rate is not published by 3:00 p.m., New York City time, on the interest determination date, the federal funds (open) rate will be the rate on that interest determination date as published on Bloomberg, or another recognized electronic source used for the purpose of displaying the applicable rate, on the "FEDSPREB Index" page.

- If the above rate is not yet published on either the Reuters screen "5" page or the Bloomberg screen "FEDSPREB Index" page by 3:00 p.m., New York City time, on the interest determination date, the calculation agent will determine the federal funds (open) rate to be the arithmetic mean of the rates for the last transaction in overnight U.S. dollar federal funds by each of three leading brokers of U.S. dollar federal funds transactions in New York City, which may include the agent and its affiliates, selected by the calculation agent, after consultation with us, prior to 9:00 a.m., New York City time, on that interest determination date.

- If fewer than three leading brokers of U.S. dollar federal funds transactions in New York City selected by the calculation agent provide quotes as set forth above, the federal funds rate for the interest determination date will be the federal funds (open) rate for the first day immediately preceding the relevant interest determination date for which that rate is published in H.15(519) under the heading "Federal funds (open)," or, if later, the first day immediately preceding the relevant interest determination date for which that rate was published on Bloomberg, or another recognized source used for the purpose of displaying the applicable rate, on FEDSPREB Index.

LIBOR

Notes having a coupon based on the London Interbank Offered Rate ("LIBOR") will bear interest at the interest rates specified in the applicable pricing supplement. The calculation agent will determine LIBOR for each interest determination date as follows:

- As of the interest determination date, LIBOR will be the arithmetic mean of the offered rates for deposits in the index currency having the index maturity designated in the applicable pricing supplement, commencing on that interest determination date, that appear on the Designated Screen Page, as defined below, as of 11:00 a.m., London time, on that interest determination date, if at least two offered rates appear on the Designated Screen Page; except that if the Designated Screen Page, by its terms provides only for a single rate, that single rate will be used.

- If (i) fewer than two offered rates appear on the Designated Screen Page and the Designated Screen Page does not by its terms provide only for a single rate or (ii) no rate appears on the Designated Screen Page and the Designated Screen Page by its terms provides only for a single rate, then the calculation agent will request the principal London offices of each of four major reference banks in the London interbank market, as selected by the calculation agent after consultation with us, to provide the calculation agent with its offered quotation for the rate of interest on deposits in the index currency for the period of the index maturity specified in the applicable pricing supplement commencing on that interest determination date or, if pounds sterling is the index currency, commencing on that interest determination date, to prime banks in the London interbank market at approximately 11:00 a.m., London time, on that interest determination date and in a principal amount that is representative of a single transaction in that index currency in that market at that time.

- If at least two quotations are provided, LIBOR determined on that interest determination date will be the arithmetic mean of those quotations. If fewer than two quotations are provided, LIBOR will be determined for the applicable interest reset date as the arithmetic mean of the rates quoted at approximately 11:00 a.m.,

London time, or some other time specified in the applicable pricing supplement, in the applicable principal financial center for the country of the index currency on that interest reset date, by three major banks in that principal financial center selected by the calculation agent, after consultation with us, for loans in the index currency to leading European banks, having the index maturity specified in the applicable pricing supplement and in a principal amount that is representative of a single transaction in that index currency in that market at that time.

- If fewer than three major banks in that principal financial center selected by the calculation agent provide quotes as set forth above, LIBOR for that interest determination date will be the rate (with the applicable index maturity) that appears on the Designated Screen Page on the first day immediately preceding the relevant interest determination date for which a rate (with the applicable index maturity) is published on the Designated Screen Page.

The "index currency" means the currency specified in the applicable pricing supplement as the currency for which LIBOR will be calculated, or, if the euro is substituted for that currency, the index currency will be the euro. If the index currency is not specified in the applicable pricing supplement, the index currency will be U.S. dollars.

"Designated Screen Page" means the screen page displayed by Reuters, Bloomberg or any other service that is specified in the applicable pricing supplement, or any other page as may replace that page on that service, for the purpose of displaying the London interbank rates of major banks for the applicable index currency published by the administrator of LIBOR.

"One-month LIBOR" means the rate displayed on the Designated Screen Page with a designated maturity of one month commencing on the interest reset date.

"Three-month LIBOR" means the rate displayed on the Designated Screen Page with a designated maturity of three months commencing on the interest reset date.

"Six-month LIBOR" means the rate displayed on the Designated Screen Page with a designated maturity of six months commencing on the interest reset date.

"One-year LIBOR" means the rate displayed on the Designated Screen Page with a designated maturity of one year commencing on the interest reset date.

"Twenty-month LIBOR" means the rate displayed on the Designated Screen Page with a designated maturity of 20 months commencing on the interest reset date.

If no Designated Screen Page is specified in the applicable pricing supplement, and, if the U.S. dollar is the index currency, LIBOR will be determined as if Reuters screen LIBOR01 had been specified.

Prime Rate

The "prime rate" means, for any interest determination date, the rate on that date as published in H.15(519) under the heading "Bank Prime Loan" on that interest determination date.

The following procedures will be followed if the prime rate cannot be determined as described above:

- If the above rate is not so published prior to 3:00 p.m., New York City time, on the interest determination date, then the prime rate will be the rate on that interest determination date as published in H.15 Daily Update under the heading "Bank Prime Loan."

- If the rate is not so published in either H.15(519) or the H.15 Daily Update by 3:00 p.m., New York City time, on the interest determination date, then the calculation agent will determine the prime rate to be the arithmetic mean of the rates of interest publicly announced by each bank that appears on the Reuters screen "USPRIME 1" page, as defined below, as that bank's prime rate or base lending rate as in effect for that interest determination date.

- If fewer than four rates appear on the Reuters screen "USPRIME 1" page by 3:00 p.m., New York City time, for that interest determination date, the calculation agent will determine the prime rate to be the arithmetic mean of the prime rates quoted on the basis of the actual number of days in the year divided by 360 as of the close of business on that interest determination date by at least three major banks in New York City, which may include affiliates of the agent, selected by the calculation agent, after consultation with us.

- If fewer than three major banks in New York City selected by the calculation agent provide quotes as set forth above, the prime rate for that interest determination date will be the rate for the first day immediately preceding that interest determination date for which that rate is published in H.15(519) under the heading "Bank Prime Loan," or if later, the first day immediately preceding the relevant interest determination date for which that rate was published in H.15 Daily Update under the heading "Bank Prime Loan."

"Reuters screen USPRIME 1 page" means the display designated as page "USPRIME 1" on the Reuters Monitor Money Rates Service, or any successor service, or any other page as may replace the "USPRIME 1" page on that service for the purpose of displaying prime rates or base lending rates of major U.S. banks.

Treasury Rate

The "Treasury rate" for any interest determination date means:

- the rate from the auction held on the applicable interest determination date, which we refer to as the "auction," of direct obligations of the United States, which are commonly referred to as "Treasury Bills," having the index maturity specified in the applicable pricing supplement as that rate appears under the caption "INVEST RATE" on the Reuters screen "USAUCTION 10/13" page; or

- if the rate described in the first bullet point is not so published by 3:00 p.m., New York City time, on the interest determination date, the bond equivalent yield of the rate for the applicable Treasury Bills as published in the H.15 Daily Update, or other recognized electronic source used for the purpose of displaying the applicable rate, under the caption "U.S. Government notes/Treasury Bills/Auction High"; or

- if the rate described in the second bullet point is not so published by 3:00 p.m., New York City time, on the related interest determination date, the bond equivalent yield of the auction rate of the applicable Treasury Bills, announced by the U.S. Department of the Treasury; or

- if the rate referred to in the third bullet point is not so announced by the U.S. Department of the Treasury, or if the auction is not held, the bond equivalent yield of the rate on the applicable interest determination date of Treasury Bills having the index maturity specified in the applicable pricing supplement published in H.15(519) under the caption "U.S. Government notes/Treasury Bills/Secondary Market"; or

- if the rate referred to in the fourth bullet point is not so published by 3:00 p.m., New York City time, on the related interest determination date, the rate on the applicable interest determination date of the applicable Treasury Bills as published in H.15 Daily Update, or other recognized electronic source used for the purpose of displaying the applicable rate, under the caption "U.S. Government notes/Treasury Bills/Secondary Market"; or

- if the rate referred to in the fifth bullet point is not so published by 3:00 p.m., New York City time, on the related interest determination date, the rate on the applicable interest determination date calculated by the calculation agent as the bond equivalent yield of the arithmetic mean of the secondary market bid rates, as of approximately 3:30 p.m., New York City time, on the applicable interest determination date, of three primary U.S. government securities dealers, which may include the agent and its affiliates, selected by the calculation agent, for the issue of Treasury Bills with a remaining maturity closest to the index maturity specified in the applicable pricing supplement; or

- if the dealers selected by the calculation agent are not quoting as set forth above, the Treasury rate for that interest determination date will be determined by the calculation agent in its sole discretion.

The "bond equivalent yield" means a yield calculated in accordance with the following formula and expressed as a percentage:

$$\text{bond equivalent yield} = \frac{(\mathrm{D} \times \mathrm{M})}{360 - (\mathrm{D} \times \mathrm{M})} \times 100$$

where "D" refers to the applicable per annum rate for Treasury Bills quoted on a bank discount basis, "N" refers to the number of days in the applicable year, as the case may be, and "M" refers to the actual number of days in the interest reset period for which interest is being calculated.

Equity Securities

The principal, interest or any other amounts payable on or any other property deliverable in respect of the notes, and the amount of money or warrant property payable or deliverable in respect of the warrants, may be based on the performance of the shares of one or more equity securities, including price movements in or other events relating to those equity securities. The shares of equity securities may consist of American depositary shares, which are described under "Reference Assets—Equity Securities—American Depositary Shares and Deposit Agreements" below. Unless the context requires otherwise, references in this prospectus supplement to the issuer of an equity security that is an American depositary share refers to the issuer of the corresponding ADS underlying shares (as described below). Under no circumstances will we offer or issue warrants pursuant to this prospectus supplement for the purchase or sale of our ordinary shares or the ordinary shares of Barclays PLC.

Reference Asset Issuer and Reference Asset Information

The securities are not issued, endorsed, sponsored or promoted by and are not financial or legal obligations of the issuer of the underlying equity securities, nor does the issuer of the underlying equity securities opine on the legality or suitability of the securities. The trademarks, service marks or registered trademarks of the issuer of the equity securities are the property of their owner. The issuer of the reference asset makes no warranties and bears no liabilities with respect to the securities or to the administration or operation of the securities. This prospectus supplement relates only to the securities offered by the applicable pricing supplement and does not relate to any security of an underlying issuer.

If the reference asset is an equity security that is registered under the Securities Exchange Act of 1934, as amended, which is commonly referred to as the "Exchange Act," issuers of those equity securities are required to file periodically financial and other information specified by the SEC. Information provided to or filed with the SEC can be inspected and copied at the public reference facilities maintained by the SEC at Room 1580, 100 F Street, N.E., Washington, D.C. 20549, and copies of that material can be obtained from the Public Reference Section of the SEC, 100 F Street, N.E., Washington, D.C. 20549, at prescribed rates. You may obtain information on the operation of the public reference room by calling the SEC at 1-800-SEC-0330. In addition, information provided to or filed with the SEC electronically can be accessed through a website maintained by the SEC. The address of the SEC's website is http://www.sec.gov. Information provided to or filed with the SEC pursuant to the Exchange Act by a company issuing the equity securities can be located by reference to the SEC file number provided in the applicable pricing supplement. In addition, information regarding a company issuing the equity security may be obtained from other sources including, but not limited to, press releases, newspaper articles and other publicly disseminated documents. We make no representation or warranty as to the accuracy or completeness of the information referred to above relating to equity securities or any other publicly available information regarding the issuer of the reference asset. We and our affiliates have not participated in the preparation of the above-described documents or made any due diligence inquiry with respect to the issuer of the reference asset. Furthermore, we cannot give any assurance that all events occurring prior to the date of the applicable pricing supplement (including events that would affect the accuracy or completeness of the publicly available documents described in this prospectus supplement) that would affect the closing prices of the reference asset (and therefore the closing price of that reference asset at the time we price the securities) have been publicly disclosed. Subsequent disclosure of, or the failure of the issuer to disclose, any of those events or the disclosure of or failure to disclose material future events concerning the issuer of the reference asset could adversely affect any amounts payable or property deliverable on the securities and the price of the securities in the secondary market, if any.

Special Calculation Provisions

Unless otherwise specified in the applicable pricing supplement, with respect to reference assets that are shares of equity securities, the closing price for any security on any day will equal the closing sale price or last reported sale price, regular way, for the security, on a per-share or other unit basis:

- on the principal U.S. national securities exchange on which that security is listed for trading on that day, or
- if that security is not listed on any U.S. national securities exchange, on any other U.S. national market system that is the primary market for the trading of that security.

With respect to the closing sale price or last reported sale price for the NASDAQ, the closing price will be the NASDAQ Official Closing Price (NOCP), unless otherwise specified in the applicable pricing supplement.

If that security is not listed or traded as described above, then the closing price for that security on any day will be determined by the calculation agent. In determining the closing price for that security on any day, the calculation agent may consider any relevant information, including, without limitation, information consisting of relevant market data in the relevant market supplied by one or more third parties or internal sources including, without limitation, relevant rates, prices, yields, yield curves, volatiles, spreads, correlations or other relevant market data in the relevant market.

American Depositary Shares and Deposit Agreements

Any reference asset in the form of an American depositary share is issued pursuant to a deposit agreement, as amended from time to time (the "deposit agreement"). An event that has a diluting or concentrative effect on the corresponding ADS underlying shares may affect the theoretical value of those American depositary shares, unless (and to the extent that) the issuer of the ADS underlying shares or the depositary for the American depositary shares, pursuant to their authority (if any) under the deposit agreement, elects to adjust the number of ADS underlying shares that are represented by each American depositary share such that the price and other terms of the American depositary share will not be affected by any such event. If the issuer of the ADS underlying shares or the depositary for the American depositary share does not adjust the number of ADS underlying shares that are represented by each American depositary share, or makes an adjustment that the calculation agent deems inappropriate to account for such an event, then the calculation agent may make any adjustments that the calculation agent determines to be appropriate to account for that event. The depositary of the American depositary shares may also have the ability pursuant to the deposit agreement to make adjustments in respect of the American depositary shares for share distributions, rights distributions, cash distributions and distributions other than shares, rights and cash. Upon any such adjustment by the depositary, the calculation agent may adjust such terms and conditions of the securities as the calculation agent determines appropriate to account for that event.

"ADS underlying shares" means with respect to a reference asset that is an American depositary share, the securities of the issuer underlying that reference asset.

Market Disruption Events for Securities with an Equity Security as a Reference Asset

For purposes of this subsection "Market Disruption Events for Securities with an Equity Security as a Reference Asset," all references to "shares" of equity securities include any corresponding ADS underlying shares unless otherwise specified. Any of the following will be a market disruption event where the reference asset is shares of an equity security:

- a suspension, absence or material limitation of trading in (1) the shares in their primary market, as determined by the calculation agent, or (2) futures or options contracts relating to the shares in the primary market for those contracts, as determined by the calculation agent, in either case for more than two hours of trading or at any time during the one-half hour period preceding the close of the regular trading session in that market or, if the relevant valuation time is not the close of the regular trading session in that market, the relevant valuation time;

- any event that materially disrupts or impairs, as determined by the calculation agent, the ability of market participants in general to (1) effect transactions in, or obtain market values for, the shares in their primary market, or (2) effect transactions in, or obtain market values for, futures or options contracts relating to the shares in the primary market for those contracts, in either case for more than two hours of trading or at any time during the one-half hour period preceding the close of the regular trading session in that market or, if the relevant valuation time is not the close of the regular trading session in that market, the relevant valuation time;

- the closure on any scheduled trading day of the primary market for the shares prior to the scheduled weekday closing time of that market (without regard to after hours or any other trading outside of the regular trading session hours) unless the earlier closing time is announced by the primary market at least one hour prior to the earlier of (1) the actual closing time for the regular trading session on that primary market on that scheduled trading day for that primary market and (2) the submission deadline for orders to be entered into the relevant exchange system for execution at the close of trading on that scheduled trading day for that primary market; or

- any scheduled trading day on which (1) the primary market for the shares or (2) the exchanges or quotation systems, if any, on which futures or options contracts relating to the shares are traded, fails to open for trading during its regular trading session.

For the purposes of this prospectus supplement and unless otherwise specified in the relevant pricing supplement, "scheduled trading day" with respect to an equity security means any day on which the primary market for the shares is scheduled to be open for trading for its regular trading session.

The following events will not be market disruption events:

- a limitation on the hours or numbers of days of trading, but only if the limitation results from an announced change in the regular business hours of the relevant market; or

- a decision to permanently discontinue trading in the futures or options contracts relating to the shares.

For this purpose, an "absence of trading" in the primary market on which the shares are traded, or on which futures or options contracts related to the shares are traded, will not include any time when that market is itself closed for trading under ordinary circumstances.

In contrast, a suspension or limitation of trading in shares, or in futures or options contracts related to the shares, in their primary markets, by reason of any of:

- a price change exceeding limits set by that market,

- an imbalance of orders, or

- a disparity in bid and ask quotes,

will constitute a suspension or material limitation of trading in the shares or those futures and options contracts in the relevant market.

The calculation agent may postpone any valuation date if the calculation agent determines that the originally scheduled valuation date is not a scheduled trading day or that a market disruption event has occurred or is continuing on a day that would otherwise be that valuation date. Under these circumstances, that valuation date will be the first following scheduled trading day on which the calculation agent determines that a market disruption event does not occur and is not continuing.

In no event, however, will any valuation date be postponed by more than five scheduled trading days. If the calculation agent determines that a market disruption event occurs or is continuing on the fifth scheduled trading day, the calculation agent will determine the closing price for the share on that fifth scheduled trading day as the mean of the bid prices for one share for that date obtained from as many recognized dealers in that share, but not exceeding three, as will make those bid prices available to the calculation agent. Bids of Barclays Capital Inc. or any of its affiliates may be included in the calculation of that mean, but only to the extent that any such bid is the highest of the bids obtained (in the case of securities that provide long exposure to the share) or the lowest of the bids obtained (in the case of securities that provide short exposure to the share). If no bid prices are provided from any third party dealers, the calculation agent will determine the closing price for the share on that fifth scheduled trading day in good faith and in a commercially reasonable manner. In making such determination, the calculation agent may take into account any information that it deems relevant.

For securities linked to a basket or to the reference asset with the lowest or highest return in a group of two or more reference assets, if any valuation date is not a scheduled trading day or if the calculation agent determines that a market disruption event occurs or is continuing on any valuation date, that valuation date will be postponed as described under "Reference Assets—Baskets" or "Reference Assets—Least or Best Performing Reference Asset," as applicable.

Share Adjustments Relating to Securities with an Equity Security as a Reference Asset

For purposes of this subsection "Share Adjustments Relating to Securities with an Equity Security as a Reference Asset," all references to "shares" of equity securities include any corresponding ADS underlying shares unless otherwise specified.

Anti-dilution Adjustments. The calculation agent may adjust any variable described in the applicable pricing supplement, including but not limited to, if applicable, any price (including but not limited to the initial price, any price derived from the initial price, the final price and the closing price or any other relevant price on any valuation date) or physical delivery amount or any combination thereof or any other variable described in the applicable pricing supplement, if an event described below occurs on or before the final valuation date and the calculation agent determines that the event has a diluting or concentrative effect on the theoretical value of the shares.

The adjustments described below do not cover all events that could affect the market value of the securities.

How Adjustments Will Be Made. If one of the events described below occurs on or before the final valuation date and the calculation agent determines that the event has a diluting or concentrative effect on the theoretical value of the shares, the calculation agent may calculate a corresponding adjustment to any variable described in the applicable pricing supplement, including but not limited to, if applicable, any price (including but not limited to the initial price, any price derived from the initial price, the final price and the closing price or any other relevant price on any valuation date) or physical delivery amount or any combination thereof, as the calculation agent determines appropriate to account for that diluting or concentrative effect. The calculation agent will also determine the effective date of that adjustment.

If more than one event requiring adjustment occurs, the calculation agent will make such an adjustment for each event in the order in which the events occur, and on a cumulative basis. Thus, having adjusted the values for the appropriate variables for the first event, the calculation agent will adjust the appropriate values for the second event, applying the required adjustments cumulatively.

For any dilution event described below, the calculation agent will not have to adjust any variable unless the adjustment would result in a change of at least 0.1% of the unadjusted amount. The values of the variables, including but not limited to, if applicable, any price (including but not limited to the initial price, any price derived from the initial price, the final price and the closing price or any other relevant price on any valuation date) or physical delivery amount or any combination thereof or any other variable described in the applicable pricing supplement, resulting from any adjustment will be rounded up or down, as appropriate. See "Terms of the Notes—Calculations and Calculation Agent" and "Terms of the Warrants—Calculations and Calculation Agent" above.

The calculation agent will make all determinations with respect to anti-dilution adjustments, including any determination as to whether an event requiring adjustment has occurred, as to the nature of the adjustment required and how it will be made. The calculation agent will provide information about any adjustments it makes upon your written request.

The following events are those that may require an anti-dilution adjustment, in each case, if that event becomes effective after the initial valuation date for the original securities and on or before the applicable final valuation date:

- a subdivision, consolidation or reclassification of the shares of equity securities or a free distribution or dividend of any of these shares to existing holders of the shares by way of bonus, capitalization or similar issue;
- a distribution or dividend to existing holders of the shares of equity securities of:
- shares,
- other share capital or securities granting the right to payment of dividends and/or proceeds of a liquidation of the issuer of the shares equally or proportionately with those payments to holders of the shares,
- share capital or other securities of another issuer acquired or owned or owned (directly or indirectly) by the issuer of shares as a result of a spin-off or other similar type transaction, or
- any other type of securities, rights or warrants or other assets in any case for payment (in cash or otherwise) at less than the prevailing market price as determined by the calculation agent;
- the declaration by the issuer of the shares of equity securities of an extraordinary or special dividend or other distribution whether in cash or shares or other assets;
- a call by the issuer of shares of equity securities in respect of shares that are not fully paid;
- in respect of an issuer of shares of equity securities, an event that results in any shareholder rights being distributed or becoming separated from shares of common stock or other shares of capital stock of the issuer of shares of equity securities pursuant to a shareholder rights plan or arrangement directed against hostile takeovers that provides upon the occurrence of certain events for a distribution of preferred stock, warrants, debt instruments or stock rights at a price below their market value, as determined by the calculation agent, provided that any adjustment effected as a result of such an event will be readjusted upon any redemption of those rights;
- a repurchase by the issuer of shares of equity securities of its common stock whether out of profits or capital and whether the consideration for that repurchase is cash, securities or otherwise; or
- any other similar event that may have a diluting or concentrative effect on the theoretical value of the shares of equity securities.

Stock Splits. A stock split is an increase in the number of a corporation's outstanding shares of stock without any change in its stockholders' equity. Each outstanding share is worth less as a result of a stock split.

Reverse Stock Splits. A reverse stock split is a decrease in the number of a corporation's outstanding shares of stock without any change in its stockholders' equity. Each outstanding share is worth more as a result of a reverse stock split.

Extraordinary Dividends. A dividend or other distribution with respect to the shares of equity securities will be deemed to be an "extraordinary dividend" if, as determined by the calculation agent, it is (1) a payment by the issuer of the shares of equity securities to holders of the shares that such issuer announces will be an extraordinary dividend; (2) a payment by the issuer of the shares of equity securities to holders of these shares out of that issuer's capital and surplus; or (3) any other "special" cash or non-cash dividend on, or distribution with respect to, the shares which is, by its terms or declared intent, declared and paid outside the normal operations or normal dividend procedures of the relevant issuer. The ex-dividend date for any dividend or other distribution is the first day on which the shares trade without the right to receive that dividend or distribution.

To the extent an extraordinary dividend is not paid in cash, the value of the non-cash component will be determined by the calculation agent. If an extraordinary dividend occurs after the applicable initial valuation date and on or before the applicable final valuation date and the calculation agent determines that such event has a diluting or concentrative effect on the theoretical value of the shares, the calculation agent will adjust any variables it determines appropriate to account for that diluting or concentrative effect.

Reorganization Events. Each of the following is a reorganization event in respect of the shares of equity securities, provided that, in each case, the closing date of the event occurs on or before the final valuation date:

- any reclassification or change of the shares that results in the transfer of or an irrevocable commitment to transfer all of the outstanding shares to another person or entity;

- the shares have been subject to a merger, consolidation, amalgamation or binding share exchange which is not a merger, consolidation, amalgamation or binding share exchange in which the issuer of the shares is the surviving entity and which does not result in the reclassification or change of all of the outstanding shares;

- any takeover offer, tender offer, exchange offer, solicitation, proposal or other event by any entity or person that results in that entity or person purchasing, or otherwise obtaining or having the right to obtain, by conversion or other means, not less than 100% of the outstanding voting shares (other than shares of the equity securities owned or controlled by that other entity or person) as determined by the calculation agent, based upon the making of filings with governmental or self-regulatory agencies or any other information as the calculation agent deems relevant; or

- any consolidation, amalgamation, merger or binding share exchange of the issuer of the shares or its subsidiaries with or into another entity in which the issuer of the shares is the continuing entity and which does not result in a reclassification or change of all such outstanding shares but results in the outstanding shares (other than shares of the equity securities owned or controlled by that other entity) immediately prior to that event collectively representing less than 50% of the outstanding shares immediately following that event.

Adjustments for Reorganization Events. For purposes of this subsection "Adjustments for Reorganization Events," references to "shares" of equity securities do not include the corresponding ADS underlying shares.

If a reorganization event occurs with respect to the shares of equity securities or any corresponding ADS underlying shares and the consideration for the shares consists solely of new shares (exclusive of fractional share cash amounts) that are publicly quoted, traded or listed on any of the New York Stock Exchange, NYSE MKT or the NASDAQ (or their respective successors), then the shares of the equity securities will be adjusted to comprise the new number of shares to which a holder of one share of the equity securities immediately prior to the occurrence of the reorganization event, as the case may be, would be entitled upon consummation of that reorganization event, and the calculation agent will adjust any variable that the calculation agent determines appropriate to account for the reorganization event.

If the new shares offered as consideration for the shares of the equity securities are not publicly quoted, traded or listed on any of the New York Stock Exchange, NYSE MKT or the NASDAQ (or their respective successors), then (1) in the case of the notes, the calculation agent will accelerate the maturity date to the day that is four business days after the approval date (as described below) and the calculation agent will calculate the amount payable on the notes (inclusive of the value of the embedded options) that would preserve for you the economic equivalent of any remaining payment obligations with respect to the notes hereunder; and (2) in the case of the warrants, the calculation agent will accelerate the relevant exercise date to the day that is four business days after the approval date (as described below) and the calculation agent will calculate the amount of money or warrant property payable or deliverable in respect of the warrants as the relevant exercise date is so accelerated. For purposes of calculating the amount payable on the notes or the amount of money or warrant property payable or deliverable in respect of the warrants, as applicable, the final price will be determined by the calculation agent and will be deemed to be the value of all consideration received (or that would be received) in respect of that reorganization event and the final valuation date will be deemed to occur on the approval date. The "approval date" means the closing date with respect to each of the first, second and fourth reorganization events described above or the date on which the person

or entity making the offer, solicitation or proposal acquires the right to obtain the relevant percentage of shares of equity securities with respect to the third reorganization event described above, as the case may be.

If a reorganization event occurs and the consideration for the shares of equity securities consists (1) solely of cash and assets and other securities (other than new shares as discussed above), or (2) of new shares plus cash and assets, then (a) in the case of the notes, the calculation agent will accelerate the maturity date to the day that is four business days after the approval date (as described above) and the calculation agent will calculate the amount payable on the notes (inclusive of the value of the embedded options) that would preserve for you the economic equivalent of any remaining payment obligations with respect to the notes hereunder; and (b) in the case of the warrants, the calculation agent will accelerate the relevant exercise date to the day that is four business days after the approval date (as described above) and the calculation agent will calculate the amount of money or warrant property payable or deliverable in respect of the warrants as the relevant exercise date is so accelerated. For purposes of calculating the amount payable on the notes or the amount of money or warrant property payable or deliverable in respect of the warrants, as applicable, the final price will be determined by the calculation agent and will be deemed to be the value of all consideration received (or that would be received) in respect of that reorganization event and the final valuation date will be deemed to be the approval date.

In the case of an acceleration of the maturity date on the notes, any interest payable under the notes will be paid through and excluding the related date of the accelerated payment. If a holder of a share of equity security or any corresponding ADS underlying shares elects to receive different types or combinations of property in the reorganization event, that property will consist of the types and amounts of each type distributed to a holder that makes no election, as determined by the calculation agent.

For any reorganization event described above, the calculation agent will not have to adjust any variable or combination of variables unless the adjustment would result in a change of at least 0.1% of the unadjusted amount. The values of variables resulting from any adjustment will be rounded up or down to, as appropriate, in the case of any price, the nearest cent, in the case of the physical delivery amount, the nearest thousandth, and in the case of any percentages, the nearest hundredth of a percent, with one half cent, five hundred thousandths and five hundredth of a percent, respectively, being rounded upward.

If a reorganization event requiring adjustment occurs, the calculation agent will make any adjustments with a view to offsetting, to the extent practical, any change in your economic position relative to the securities, that results solely from that event. The calculation agent may modify any adjustments as necessary to ensure an equitable result.

Additional Adjustment Events. For purposes of this subsection "Additional Adjustment Events," references to "shares" of equity securities do not include the corresponding ADS underlying shares.

Each of the following is an additional adjustment event in respect of the shares of equity securities, or any corresponding ADS underlying shares, *provided* that, in each case, the event occurs on or before the final valuation date:

- All the assets or substantially all the assets of the issuer of the shares of equity securities or any corresponding ADS underlying shares are nationalized, expropriated or are otherwise required to be transferred to any governmental agency, authority or entity.

- By reason of the voluntary or involuntary liquidation, bankruptcy or insolvency of, or any analogous proceeding involving the issuer of the shares of equity securities, or any corresponding ADS underlying shares, (1) all of the shares of the issuer of the shares of equity securities or the issuer of any corresponding ADS underlying shares are required to be transferred to a trustee, liquidator or other similar official or (2) holders of the shares of equity securities or any corresponding ADS underlying shares become legally prohibited from transferring those shares.

- The exchange on which the shares of equity securities are traded announces that pursuant to the rules of that exchange, the shares cease (or will cease) to be listed, traded or publicly quoted on that exchange for any reason (other than a reorganization event as described above) and those shares are not immediately re-listed, re-traded or re-quoted on any of the New York Stock Exchange, NYSE MKT or the NASDAQ (or their respective successors).

If an additional adjustment event relating to the shares of equity securities or any corresponding ADS underlying shares occurs on or before the final valuation date, the calculation agent may accelerate the maturity date or relevant exercise date or period, as applicable, to the day that is four business days after the announcement date (as described below). In the event of such an acceleration, on the maturity date or the payment or settlement date so accelerated, as applicable, we will pay to you the amount payable or property deliverable in respect of the notes, or pay or deliver to you the amount of money or warrant property payable or deliverable to you in respect of the warrants, as applicable. For purposes of calculating the amount payable at maturity or at the payment or settlement date, as applicable, the final price will be determined by the calculation agent and the final valuation date will be deemed to be the business day immediately prior to the announcement date. The "announcement date" means, for purposes of this paragraph, (1) in the case of the additional adjustment event first described above, the day of the first public announcement by the relevant government authority that all or substantially all of the assets of the issuer of the shares of equity securities or the issuer of any corresponding ADS underlying shares are to be nationalized, expropriated or otherwise transferred to any governmental agency, authority or entity, (2) in the case of the second additional adjustment event described above, the day of the first public announcement of the issuer of a proceeding or presentation of a petition or passing of a resolution (or other analogous procedure in any jurisdiction) that leads to an insolvency with respect to the issuer of the shares of equity securities or any corresponding ADS underlying shares, or (3) in the case of the third additional adjustment event described above, the day of the first public announcement by the relevant exchange that the shares of the equity securities will cease to trade or be publicly quoted on that exchange. The calculation agent will then (a) in the case of the notes, calculate the amount payable or property deliverable on the notes (inclusive of the value of the embedded options) that would preserve for you the economic equivalent of any remaining payment obligations with respect to the notes hereunder; and (b) in the case of the warrants, calculate the amount of money or warrant property payable or deliverable in respect of the warrants as the relevant exercise date or period is so accelerated.

In the case of an acceleration of the maturity date on the notes, any interest payable under the notes will be paid through and excluding the related date of the accelerated payment. In the case where an additional adjustment event relating to the shares of equity securities or any corresponding ADS underlying shares occurs on or before the final valuation date and the calculation agent does not accelerate the maturity date or relevant exercise date or period, as applicable, the calculation agent may adjust any variable the calculation agent determines appropriate to account for that additional adjustment event.

Adjustments Affecting Securities Linked to More than One Reference Asset, at Least One of Which Is an Equity Security. If the securities are linked to more than one reference asset, at least one of which is an equity security, and an event occurs with respect to any such equity security that would allow the calculation agent to adjust any variable of the securities (as described above), then the calculation agent may adjust any variable in the manner described in the applicable sections of this prospectus supplement or as described in the applicable pricing supplement.

Notwithstanding the generality of the preceding paragraph, if a "reorganization event" or an "additional adjustment event" (each as defined above) occurs with respect to any equity security (an "affected share") composing the reference asset(s) on or prior to the final valuation date, then the calculation agent may, in its sole discretion, elect to make an adjustment to the initial price or final price of the affected share or any other terms of the securities as the calculation agent, in its sole discretion, determines appropriate to account for the economic effect that the reorganization event or additional adjustment event, as applicable, would have had if the securities represented an actual interest in the affected share equivalent to the notional interest of the securities in the affected share.

If the calculation agent elects not to make an adjustment as described in the preceding two paragraphs or determines that no adjustment that it could make will produce a commercially reasonable result, then the calculation agent will cause the maturity date to be accelerated to the fourth business day following the date of that determination and the payment at maturity that you will receive on the securities will be calculated as though the date of early repayment were the stated maturity date of the securities and as though the final valuation date were the approval date, in the case of a reorganization event, or the business day immediately prior to the announcement date, in the case of an additional adjustment event (or, in each case, if (i) that day is not a scheduled trading day with respect to each reference asset, or (ii) a market disruption event occurs or is continuing on that day with respect to any reference asset, the immediately preceding day that is a scheduled trading day with respect to each reference asset on which no market disruption event occurs or is continuing).

Exchange-Traded Funds

The principal, interest or any other amounts payable on or any other property deliverable in respect of the notes, and the amount of money or warrant property payable or deliverable in respect of the warrants, may be based on the performance of the shares or other interests in one or more exchange-traded funds, including price movements in or other events relating to those shares or interests.

Reference Asset Investment Company and Reference Asset Information

Exchange-traded funds are generally designed to track the performance of a portfolio of one or more categories of assets, including, among others, securities, commodities, commodity futures contracts and exchange rate contracts. A registered investment company holds all of the portfolio assets in trust and each share of the exchange-traded fund represents an undivided ownership interest in that trust. Exchange-traded funds may also have a sponsor or investment adviser. The securities are not issued, endorsed, sponsored or promoted by and are not financial or legal obligations of the issuer, sponsor or investment adviser of the exchange-traded funds or the sponsor of any underlying indices, nor does the issuer, sponsor or investment adviser of the exchange-traded funds or the sponsor of any underlying indices opine on the legality or suitability of the securities. The trademarks, service marks or registered trademarks of the issuer of the exchange-traded funds or the sponsor of any underlying indices are the property of their owner. The issuer of the reference asset makes no warranties and bears no liabilities with respect to the securities or to the administration or operation of the securities. This prospectus supplement relates only to the securities offered by the applicable pricing supplement and does not relate to the exchange-traded fund or the underlying index.

If the reference asset is shares or other interests in an exchange-traded fund that is registered under the Securities Exchange Act of 1933, as amended, and/or the Investment Company Act of 1940, as amended, the issuer of those shares or other interests is required to file periodically financial and other information specified by the SEC. Information provided to or filed with the SEC can be inspected and copied at the public reference facilities maintained by the SEC at Room 1580, 100 F Street, N.E., Washington, D.C. 20549, and copies of that material can be obtained from the Public Reference Section of the SEC, 100 F Street, N.E., Washington, D.C. 20549, at prescribed rates. You may obtain information on the operation of the public reference room by calling the SEC at 1-800-SEC-0330. In addition, information provided to or filed with the SEC electronically can be accessed through a website maintained by the SEC. The address of the SEC's website is http://www.sec.gov. Information provided to or filed with the SEC by an investment company issuing shares or other interests in an exchange-traded fund can be located by reference to the SEC file numbers provided in the applicable pricing supplement. In addition, information regarding an exchange-traded fund may be obtained from other sources including, but not limited to, press releases, newspaper articles and other publicly disseminated documents. We make no representation or warranty as to the accuracy or completeness of the information referred to above relating to exchange-traded funds. We and our affiliates have not participated in the preparation of the above-described documents or made any due diligence inquiry with respect to the issuer of the reference asset. Furthermore, we cannot give any assurance that all events occurring prior to the date of the applicable pricing supplement (including events that would affect the accuracy or completeness of the publicly available documents described in this prospectus supplement) that would affect the closing prices of the reference asset (and therefore the closing price of that reference asset at the time we price the securities) have been publicly disclosed. Subsequent disclosure of any of those events or the disclosure of or failure to disclose material future events concerning the issuer of the reference asset could adversely affect the value received at maturity or at the payment or settlement date, and therefore the price of the securities in the secondary market, if any.

Special Calculation Provisions

Unless otherwise specified in the applicable pricing supplement, with respect to reference assets that are shares or other interests in exchange-traded funds, the closing price for any security on any day will equal the closing sale price or last reported sale price, regular way, for the security, on a per-share or other unit basis:

- on the principal U.S. national securities exchange on which that security is listed for trading on that day, or
- if that security is not listed on any U.S. national securities exchange, on any other U.S. national market system that is the primary market for the trading of that security.

With respect to the closing sale price or last reported sale price for the NASDAQ, the closing price will be the NASDAQ Official Closing Price (NOCP), unless otherwise specified in the applicable pricing supplement.

If that security is not listed or traded as described above, then the closing price for that security on any day will be determined by the calculation agent. In determining the closing price for that security on any day, the calculation agent may consider any relevant information, including, without limitation, information consisting of relevant market data in the relevant market supplied by one or more third parties or internal sources including, without limitation, relevant rates, prices, yields, yield curves, volatiles, spreads, correlations or other relevant market data in the relevant market.

Scheduled Trading Days

For the purposes of this prospectus supplement and unless otherwise specified in the relevant pricing supplement, "scheduled trading day" with respect to an exchange-traded fund means any day on which the relevant exchange is scheduled to be open for trading for its regular trading session.

Market Disruption Events for Securities with an Exchange-Traded Fund That Holds Equity Securities as a Reference Asset

A valuation date may be postponed and thus the determination of the price of the shares or other interests in an exchange-traded fund may be postponed if that valuation date is not a scheduled trading day or if the calculation agent determines that, on that valuation date, a market disruption event has occurred or is continuing in respect of the shares or other interests in the exchange-traded fund.

Any of the following will be a market disruption event with respect to an exchange-traded fund holding equity securities:

- a suspension, absence or material limitation of trading in (1) the shares of, or other interests in, the exchange-traded fund on the relevant exchange (as defined below), (2) the securities constituting 20% or more, by weight, of the underlying index for the exchange-traded fund, on their respective primary markets, (3) futures or options contracts relating to the shares of, or other interests in, the exchange-traded fund in the primary market for those contracts, (4) futures or options contracts relating to the underlying index for the exchange-traded fund in the primary market for those contracts, or (5) futures or options contracts relating to the securities constituting 20% or more, by weight, of the underlying index for the exchange-traded fund in the respective primary markets for those contracts; in each case for more than two hours of trading or at any time during the one-half hour period preceding the close of the regular trading session in that market or, if the relevant valuation time is not the close of the regular trading session in that market, the relevant valuation time;

- any event that materially disrupts or impairs, as determined by the calculation agent, the ability of market participants in general to (1) effect transactions in, or obtain market values for, the shares of, or other interests in, the exchange-traded fund on the relevant exchange, (2) effect transactions in, or obtain market values for, securities constituting 20% or more, by weight, of the underlying index for the exchange-traded fund on their respective primary markets, (3) effect transactions in, or obtain market values for, futures or options contracts relating to the exchange-traded fund in their primary market, (4) effect transactions in, or obtain market values for, futures or options contracts relating to the underlying index for the exchange-traded fund in the primary market for those contracts, or (5) effect transactions in, or obtain market values for, futures or options contracts relating to the securities constituting 20% or more, by weight, of the underlying index for the exchange-traded fund in the respective primary markets for those contracts; in each case at any time during the one-half hour period preceding the close of the regular trading session in that market or, if the relevant valuation time is not the close of the regular trading session in that market, the relevant valuation time;

- the closure on any scheduled trading day of the relevant exchange prior to the scheduled weekday closing time of that exchange (without regard to after hours or any other trading outside of the regular trading session hours) unless the earlier closing time is announced by the relevant exchange at least one hour prior to the earlier of (1) the actual closing time for the regular trading session on that scheduled trading day for the relevant exchange and (2) the submission deadline for orders to be entered into the relevant exchange system for execution at the close of trading on that scheduled trading day for the relevant exchange; or

- any scheduled trading day on which the relevant exchange fails to open for trading during its regular trading session.

The following events will not be market disruption events:

- a limitation on the hours or numbers of days of trading, but only if the limitation results from an announced change in the regular business hours of the relevant market; and

- a decision to permanently discontinue trading in the exchange-traded fund or the option or futures contracts relating to the exchange-trade fund or the underlying index for the exchange-traded fund.

For this purpose, an "absence of trading" in the primary market on which shares of the exchange-traded fund or any security included in the underlying index for the exchange-traded fund are traded or on which option or futures contracts relating to the exchange-traded fund, the underlying index for the exchange-traded fund or any security included in that underlying index are traded will not include any time when the relevant market is itself closed for trading under ordinary circumstances. In contrast, a suspension or limitation of trading in the shares of the exchange-traded fund or any security included in the underlying index for the exchange-traded fund, on or in options or futures contracts relating to the exchange-traded fund, the underlying index for the exchange-traded fund or any security included in that underlying index, by reason of any of:

- a price change exceeding limits set by the relevant market,

- an imbalance of orders, or

- a disparity in bid and ask quotes

will constitute a suspension or material limitation of trading in the shares of the exchange-traded fund or any security included in the underlying index for the exchange-traded fund, or in option or futures contracts relating to the exchange-traded fund, the underlying index for the exchange-traded fund or any security included in that underlying index, as the case may be, in the relevant market.

For the purpose of determining whether a market disruption event with respect to the exchange-traded fund exists at any time, if trading in a security included in the underlying index for the exchange-traded fund is materially suspended or limited at that time, then the relevant percentage contribution of that security to the level of that underlying index will be based on a comparison of (x) the portion of the level of that underlying index attributable to that security relative to (y) the overall level of that underlying index, in each case immediately before that suspension or limitation.

"Relevant exchange" means the primary exchange or market of trading for the shares or other interests in the exchange-traded fund or the shares of any successor fund.

The calculation agent may postpone any valuation date if the calculation agent determines that the originally scheduled valuation date is not a scheduled trading day or that a market disruption event has occurred or is continuing on a day that would otherwise be that valuation date. Under these circumstances, that valuation date will be the first following scheduled trading day on which the calculation agent determines that no market disruption event occurs or is continuing.

In no event, however, will any valuation date be postponed by more than five scheduled trading days. If the calculation agent determines that a market disruption event occurs or is continuing on the fifth scheduled trading day, the calculation agent will determine the closing price for the exchange-traded fund on that fifth scheduled trading day in good faith and in a commercially reasonable manner.

For securities linked to a basket or to the reference asset with the lowest or highest return in a group of two or more reference assets, if any valuation date is not a scheduled trading day or if the calculation agent determines that a market disruption event occurs or is continuing on any valuation date, that valuation date will be postponed as described under "Reference Assets—Baskets" or "Reference Assets—Least or Best Performing Reference Asset," as applicable.

Market Disruption Events for Securities with an Exchange-Traded Fund That Does Not Hold Equity Securities as a Reference Asset

A valuation date may be postponed and thus the determination of the price of the shares or other interests in an exchange-traded fund may be postponed if that valuation date is not a scheduled trading day or if the calculation agent determines that, on that valuation date, a market disruption event has occurred or is continuing in respect of the shares or other interests in the exchange-traded fund.

Any of the following will be a market disruption event with respect to an exchange-traded fund not holding equity securities:

- a suspension, absence or material limitation of trading in the exchange-traded fund on the relevant exchange (as defined below), as determined by the calculation agent;
- any event that materially disrupts or impairs, as determined by the calculation agent, the ability of market participants to effect transactions in, or obtain market values for, the exchange-traded fund on the relevant exchange;
- the closure on any scheduled trading day of the relevant exchange prior to the scheduled weekday closing time of that exchange (without regard to after hours or any other trading outside of the regular trading session hours) unless the earlier closing time is announced by the relevant exchange at least one hour prior to the earlier of (1) the actual closing time for the regular trading session on that scheduled trading day for the relevant exchange and (2) the submission deadline for orders to be entered into the relevant exchange system for execution at the close of trading on that scheduled trading day for the relevant exchange; or
- any scheduled trading day on which the relevant exchange fails to open for trading during its regular trading session.

A limitation on the hours or numbers of days of trading, but only if the limitation results from an announced change in the regular business hours of the relevant exchange, will not be deemed a market disruption event.

In contrast, a suspension or limitation of trading in the shares or other interests in the exchange-traded fund on the relevant exchange, by reason of any of:

- a price change exceeding limits set by the relevant exchange,
- an imbalance of orders, or
- a disparity in bid and ask quotes

will constitute a suspension or material limitation of trading.

"Relevant exchange" means the primary exchange or market of trading for the shares or other interests in the exchange-traded fund or the shares of any successor fund.

The calculation agent may postpone any valuation date if the calculation agent determines that the originally scheduled valuation date is not a scheduled trading day or that a market disruption event has occurred or is continuing on a day that would otherwise be that valuation date. Under these circumstances, that valuation date will be the first following scheduled trading day on which the calculation agent determines that no market disruption event occurs or is continuing.

In no event, however, will any valuation date be postponed by more than five scheduled trading days. If the calculation agent determines that a market disruption event occurs or is continuing on the fifth scheduled trading day, the calculation agent will determine the closing price for the exchange-traded fund on that fifth scheduled trading day in good faith and in a commercially reasonable manner.

For securities linked to a basket or to the reference asset with the lowest or highest return in a group of two or more reference assets, if any valuation date is not a scheduled trading day or if the calculation agent determines that a market disruption event occurs or is continuing on any valuation date, that valuation date will be postponed as described under "Reference Assets—Baskets" or "Reference Assets—Least or Best Performing Reference Asset," as applicable.

Adjustments Relating to Securities with an Exchange-Traded Fund as a Reference Asset

Discontinuance of the Exchange-Traded Fund. If the shares or other interests of the exchange-traded fund are de-listed from the relevant exchange or if the fund is liquidated or otherwise terminated, the calculation agent will substitute shares or other interests of an exchange-traded fund (such substituted exchange-traded fund being referred to herein as a "successor fund") that the calculation agent determines, in its sole discretion, is comparable to the discontinued exchange-traded fund (or discontinued successor fund). If a successor fund is selected, that successor fund will be substituted for the discontinued exchange-traded fund (or discontinued successor fund) for all purposes of the securities. Upon any selection by the calculation agent of a successor fund, the calculation agent may adjust any variable described in the applicable pricing supplement (including, without limitation, any variable relating to the price of the shares or other interests in the exchange-traded fund, the number of those shares or other interests outstanding, created or redeemed or any dividend or other distribution made in respect of those shares or other interests), as, in the good faith judgment of the calculation agent, may be and for such time as may be necessary to render the shares or other interests of the successor fund comparable to the shares or other interests of the discontinued exchange-traded fund (or discontinued successor fund) for purposes of the securities.

If the shares or other interests of a successor fund are selected by the calculation agent, those shares or other interests will be used as a substitute for the reference asset for all purposes, including for purposes of determining whether a market disruption event exists with respect to those shares or other interests.

If the shares or other interests of an exchange-traded fund (or any successor fund) are de-listed or the exchange-traded fund (or any successor fund) is liquidated or otherwise terminated and the calculation agent determines that no successor fund is available, then the calculation agent may, at its sole discretion, accelerate the maturity date or relevant exercise date or period, as applicable, to the day that is four business days after the date of that de-listing, liquidation or termination, as applicable. In the event of such an acceleration, we will pay to you the amount payable or property deliverable at maturity, or we will pay or deliver to you the amount of money or warrant property payable or deliverable to you at the payment or settlement date, as applicable, and for the purposes of that calculation, the final price will be deemed to be the closing price on the trading day corresponding to the date of the de-listing, liquidation or termination (or, if that date is not a trading day, the immediately preceding trading day), unless the calculation agent determines in its sole discretion that another day is more appropriate to, as closely as reasonably possible, replicate the discontinued exchange-traded fund (or discontinued successor fund), in which case, the final price will be the closing price on that other day. In the event that the calculation agent decides to accelerate the maturity date or relevant exercise date or period, as applicable, and to make use of a closing price other than the price on the trading day corresponding to the date of de-listing, liquidation or termination (or the immediately preceding trading day, as applicable), the calculation agent will, in its sole discretion, calculate the appropriate closing price of the shares or other interests in the discontinued exchange-traded fund (or discontinued successor fund) on any day that such calculation is required by a computation methodology that the calculation agent determines will as closely as reasonably possible replicate the shares or other interests of the discontinued exchange-traded fund (or discontinued successor fund).

The calculation agent will be solely responsible for the method of determining and/or calculating the closing price of the shares or other interests of an exchange-traded fund (or any successor fund) and of any related determinations and calculations, and its determinations and calculations with respect thereto will be conclusive in the absence of manifest error and binding on any investor in the securities.

The calculation agent will provide information as to the method of calculating the closing price of the shares or other interests of an exchange-traded fund (or any successor fund) upon written request by any investor in the securities.

Anti-dilution Adjustments. If an event occurs which, in the sole discretion of the calculation agent, has a diluting or concentrative effect on the theoretical value of the shares of the exchange-traded fund, the calculation agent may adjust any variable described in the applicable pricing supplement, and will make such adjustments as it deems necessary to negate that diluting or concentrative effect. All such adjustments will occur in the manner described under "Reference Assets—Equity Securities—Share Adjustments Relating to Securities with an Equity Security as a Reference Asset" in this prospectus supplement.

Adjustments Affecting Securities Linked to More than One Reference Asset, at Least One of Which Is an Exchange-Traded Fund. If the securities are linked to more than one reference asset, at least one of which is an exchange-traded fund, and an event occurs with respect to any such exchange-traded fund that would allow the calculation agent to adjust any variable of the securities (as described above), then the calculation agent may adjust any variable in the manner described in the applicable sections of this prospectus supplement or as described in the applicable pricing supplement.

Notwithstanding the generality of the preceding paragraph, if the shares or other interests in any exchange-traded fund (or any successor fund) composing the reference asset(s) are de-listed or any such exchange-traded fund (or any successor fund) is liquidated or otherwise terminated on or prior to the final valuation date and the calculation agent determines that no successor fund is available, then the calculation agent may, in its sole discretion, elect to make an adjustment to the initial price or final price of the affected exchange-traded fund or any other terms of the securities as the calculation agent, in its sole discretion, determines appropriate to account for the economic effect of de-listing, liquidation or termination, as applicable, would have had if the securities represented an actual interest in the affected exchange-traded fund equivalent to the notional interest of the securities in the affected exchange-traded fund.

If the calculation agent elects not to make an adjustment as described in the preceding two paragraphs or determines that no adjustment that it could make will produce a commercially reasonable result, then the calculation agent will cause the maturity date to be accelerated to the fourth business day following the date of that determination and the payment at maturity that you will receive on the securities will be calculated as though the date of early repayment were the stated maturity date of the securities and as though the final valuation date were the date of de-listing, liquidation or termination, as applicable (or, in each case, if (i) that day is not a scheduled trading day with respect to each reference asset, or (ii) a market disruption event occurs or is continuing on that day with respect to any reference asset, the immediately preceding day that is a scheduled trading day with respect to each reference asset on which no market disruption event occurs or is continuing).

Indices

The principal, interest or any other amounts payable on or any other property deliverable in respect of the notes, and the amount of money or warrant property payable or deliverable in respect of the warrants, may be based on one or more indices, including movements in the levels of the indices, the prices of their components or other events relating to the indices.

Reference Asset Sponsor and Reference Asset Information

The securities have not been passed on by the sponsor of the reference asset as to their legality or suitability. The securities are not issued, endorsed, sponsored or promoted by and are not financial or legal obligations of the sponsor of the reference asset. The trademarks, service marks or registered trademarks of the sponsor of the reference asset are the property of their owner. The sponsor of the reference asset makes no warranties and bears no liabilities with respect to the securities or to the administration or operation of the securities. This prospectus supplement relates only to the securities offered by the applicable pricing supplement and does not relate to any index of a sponsor.

Information regarding a reference asset composed of an index or the sponsor of the reference asset may be obtained from various public sources including, but not limited to, press releases, newspaper articles, the sponsor website and other publicly disseminated documents. We make no representation or warranty as to the accuracy or completeness of the information referred to above relating to the reference asset or any other publicly available

information regarding the sponsor of the reference asset. In connection with any issuance of securities under this prospectus supplement, neither we nor the agents have participated in the preparation of the above-described documents or made any due diligence inquiry with respect to the sponsor of the reference asset. Furthermore, we cannot give any assurance that all events occurring prior to the date of the applicable pricing supplement (including events that would affect the accuracy or completeness of the publicly available documents described in this prospectus supplement) that would affect the levels of the reference asset (and therefore the levels of the reference asset at the time we price the securities) have been publicly disclosed. Subsequent disclosure of any such events or the disclosure of or failure to disclose material future events concerning the sponsor of the reference asset could adversely affect any amounts payable or property deliverable on the securities and the market value of the securities in the secondary market, if any.

Special Calculation Provisions

Unless otherwise specified in the applicable pricing supplement, with respect to reference assets that are indices, the closing level for any such index on any scheduled trading day will equal the closing level of that index as published at the regular weekday close of trading on that scheduled trading day displayed on the Bloomberg Professional® service page for that index or any successor page on Bloomberg Professional® service or any successor service, as applicable.

Market Disruption Events for Securities with an Index Composed of Interest Rates, Currency Exchange Rates or Other Assets or Variables (Other than Equity Securities or Commodities) as a Reference Asset

A valuation date may be postponed and thus the determination of the index levels may be postponed if that valuation date is not a scheduled trading day (as defined below) or if the calculation agent determines that, on that valuation date, a market disruption event has occurred or is continuing in respect of an index.

Any interest rate, currency exchange rate, currency or other asset or variable (other than equity securities or commodities) that composes an index is herein referred to as an "index component." See "Reference Assets—Indices—Market Disruption Events for Securities with an Index of Equity Securities as a Reference Asset" below for a discussion of market disruption events applicable to an index of equity securities and "Reference Assets—Indices—Market Disruption Events for Securities with an Index Composed of Commodities as a Reference Asset" below for a discussion of market disruption events applicable to an index of commodities.

Unless otherwise specified in the applicable pricing supplement, any of the following will be a market disruption event with respect to an index of interest rates, currency exchange rates or other assets or variables (other than equity securities or commodities):

- a suspension, absence or material limitation of trading in index components constituting 20% or more, by weight, of that index;
- a suspension, absence or material limitation of trading in futures or options contracts relating to that index on their respective markets;
- any event that materially disrupts or impairs, as determined by the calculation agent, the ability of market participants to (1) effect transactions in, or obtain market values for, index components constituting 20% or more, by weight, of that index, or (2) effect transactions in, or obtain market values for, futures or options contracts relating to that index on their respective markets;
- the closure on any day of the primary market for futures or options contracts relating to that index or index components constituting 20% or more, by weight, of that index on a scheduled trading day prior to the scheduled weekday closing time of that market (without regard to after hours or any other trading outside of the regular trading session hours) unless that earlier closing time is announced by the primary market at least one hour prior to the earlier of (1) the actual closing time for the regular trading session on that primary market on that scheduled trading day for that primary market and (2) the submission deadline for orders to be entered into the relevant exchange system for execution at the close of trading on that scheduled trading day for that primary market; or

- any scheduled trading day on which (1) the primary markets for index components constituting 20% or more, by weight, of that index or (2) the exchanges or quotation systems, if any, on which futures or options contracts on that index are traded, fails to open for trading during its regular trading session.

For the purpose of this prospectus supplement and unless otherwise specified in the relevant pricing supplement, "scheduled trading day" with respect to an index of interest rates, currency exchange rates or other assets or variables (other than equity securities or commodities) means any day on which (a) the value of that index is scheduled to be published, and (b) the markets, if any, on which each of the index components are traded are scheduled to be open for regular trading, in each case as determined by the calculation agent in its sole discretion.

The following events will not be market disruption events:

- a limitation on the hours or number of days of trading on which any index component is traded, but only if the limitation results from an announced change in the regular business hours of the relevant market; or

- a decision to permanently discontinue trading in futures or options contracts relating to an index.

For this purpose, an "absence of trading" on an exchange or market will not include any time when the relevant exchange or market is itself closed for trading under ordinary circumstances.

In contrast, a suspension or limitation of trading in futures or options contracts related to the index, if available, in the primary market for those contracts, by reason of any of:

- a price change exceeding limits set by that market,

- an imbalance of orders relating to those contracts, or

- a disparity in bid and ask quotes relating to those contracts,

will constitute a suspension or material limitation of trading in futures or options contracts related to an index in the primary market for those contracts.

The calculation agent may postpone any valuation date if the calculation agent determines that the originally scheduled valuation date is not a scheduled trading day or that a market disruption event has occurred or is continuing on a day that would otherwise be that valuation date. Under these circumstances, that valuation date will be the first following scheduled trading day on which the calculation agent determines that no market disruption event occurs or is continuing.

In no event, however, will any valuation date be postponed by more than five scheduled trading days. If the calculation agent determines that a market disruption event occurs or is continuing on the fifth scheduled trading day, the calculation agent will determine the closing level for the reference asset on that fifth scheduled trading day in good faith and in a commercially reasonable manner.

For securities linked to a basket or to the reference asset with the lowest or highest return in a group of two or more reference assets, if any valuation date is not a scheduled trading day or if the calculation agent determines that a market disruption event occurs or is continuing on any valuation date, that valuation date will be postponed as described under "Reference Assets—Baskets" or "Reference Assets—Least or Best Performing Reference Asset," as applicable.

Market Disruption Events for Securities with an Index of Equity Securities as a Reference Asset

A valuation date may be postponed and thus the determination of the index levels may be postponed if that valuation date is not a scheduled trading day (as defined below) or if the calculation agent determines that, on that valuation date, a market disruption event has occurred or is continuing in respect of an index.

Any equity security that is a constituent of an index is referred to as an "index component" for purposes of this subsection.

Unless otherwise specified in the applicable pricing supplement, any of the following will be a market disruption event with respect to an index of equity securities:

- a suspension, absence or material limitation of trading in index components constituting 20% or more, by weight, of that index in their respective primary markets, in each case for more than two hours of trading or during the one-half hour period preceding the close of the regular trading session in that market or, if the relevant valuation time is not the close of the regular trading session in that market, the relevant valuation time;

- a suspension, absence or material limitation of trading in futures or options contracts relating to that index on their respective markets or in futures or options contracts relating to any index components constituting 20% or more, by weight, of that index in the respective primary markets for those contracts, in each case for more than two hours of trading or during the one-half hour period preceding the close of the regular trading session in that market or, if the relevant valuation time is not the close of the regular trading session in that market, the relevant valuation time;

- any event that materially disrupts or impairs, as determined by the calculation agent, the ability of market participants in general to (1) effect transactions in, or obtain market values for, index components constituting 20% or more, by weight, of that index in their respective primary markets, or (2) effect transactions in, or obtain market values for, futures or options contracts relating to that index or futures or options contracts relating to any index components constituting 20% or more, by weight, of that index in the respective primary markets for those contracts, in either case for more than two hours of trading or at any time during the one-half hour period preceding the close of the regular trading session in that market or, if the relevant valuation time is not the close of the regular trading session in that market, the relevant valuation time;

- the closure on any day of the primary market for futures or options contracts relating to that index or index components constituting 20% or more, by weight, of that index on a scheduled trading day prior to the scheduled weekday closing time of that market (without regard to after hours or any other trading outside of the regular trading session hours) unless that earlier closing time is announced by the primary market at least one hour prior to the earlier of (1) the actual closing time for the regular trading session on that primary market on that scheduled trading day for that primary market and (2) the submission deadline for orders to be entered into the relevant exchange system for execution at the close of trading on that scheduled trading day for that primary market; or

- any scheduled trading day on which (1) the primary markets for index components constituting 20% or more, by weight, of that index or (2) the exchanges or quotation systems, if any, on which futures or options contracts on that index are traded, fail to open for trading during their regular trading session.

For the purpose of this prospectus supplement and unless otherwise specified in the relevant pricing supplement, "scheduled trading day" with respect to an index of equity securities means any day on which (a) the index sponsor for that index is scheduled to publish the level of that index and (b) each exchange or quotation system, if any, on which futures or options contracts on (i) that index or (ii) index components constituting 20% or more, by weight, of that index are traded are scheduled to be open for trading for their regular trading session.

The following events will not be market disruption events:

- a limitation on the hours or number of days of trading in the relevant market only if the limitation results from an announced change in the regular business hours of the relevant market; or

- a decision to permanently discontinue trading in futures or options contracts relating to an index.

For this purpose, an "absence of trading" on an exchange or market will not include any time when the relevant exchange or market is itself closed for trading under ordinary circumstances.

In contrast, a suspension or limitation of trading in an index component in its primary market, or in futures or options contracts relating to the index or any index component, if available, in the primary market for those contracts, by reason of any of:

- a price change exceeding limits set by that market,
- an imbalance of orders relating to the index component or those contracts, as applicable, or
- a disparity in bid and ask quotes relating to the index component or those contracts, as applicable,

will constitute a suspension or material limitation of trading in that index component in its primary market or in futures or options contracts relating to the index or that index component in the primary market for those contracts.

For the purpose of determining whether a market disruption event with respect to an index exists at any time, if trading in an index component is materially suspended or limited at that time, then the relevant percentage contribution of that index component to the level of that index will be based on a comparison of (x) the portion of the level of that index attributable to that index component relative to (y) the overall level of that index, in each case immediately before that suspension or limitation.

The calculation agent may postpone any valuation date if the calculation agent determines that the originally scheduled valuation date is not a scheduled trading day or that a market disruption event has occurred or is continuing on a day that would otherwise be that valuation date. Under these circumstances, that valuation date will be the first following scheduled trading day on which the calculation agent determines that no market disruption event occurs or is continuing.

In no event, however, will any valuation date be postponed by more than five scheduled trading days. If the calculation agent determines that a market disruption event occurs or is continuing on the fifth scheduled trading day, the calculation agent will determine the closing level for the reference asset on that fifth scheduled trading day in good faith and in a commercially reasonable manner.

For securities linked to a basket or to the reference asset with the lowest or highest return in a group of two or more reference assets, if any valuation date is not a scheduled trading day or if the calculation agent determines that a market disruption event occurs or is continuing on any valuation date, that valuation date will be postponed as described under "Reference Assets—Baskets" or "Reference Assets—Least or Best Performing Reference Asset," as applicable.

Market Disruption Events for Securities with an Index Composed of Commodities as a Reference Asset

A valuation date may be postponed and thus the determination of the index levels may be postponed if that valuation date is not a scheduled trading day (as defined below) or if the calculation agent determines that, on that valuation date, a market disruption event has occurred or is continuing in respect of an index.

Any commodity or commodity futures contract constituting part of an index (including a constituent index of an index comprising multiple indices) is referred to as an "index component" for purposes of this subsection.

Unless otherwise specified in the applicable pricing supplement, any of the following will be a market disruption event with respect to an index of commodities:

- a material limitation, suspension or disruption of the trading in any index component included directly or indirectly in the index;
- the settlement price for any index component included directly or indirectly in the index is a "limit price," which means that the settlement price for that contract has increased or decreased from the previous day's settlement price by the maximum amount permitted under the applicable rules or procedures of the relevant trading facility; or
- failure by the index sponsor to announce or publish the closing value of the index or of the applicable trading facility or other price source to announce or publish the settlement price or closing level for one or more index components.

The following event will not be a market disruption event:

- a decision by a trading facility to permanently discontinue trading in any index component.

If the calculation agent determines that any valuation date (excluding the initial valuation date) is not a scheduled trading day for any index component or on any valuation date (excluding the initial valuation date) a market disruption event occurs or is continuing in respect of any index component, that valuation date will be postponed to the earlier of (i) the fifth scheduled trading day after the originally scheduled valuation date and (ii) the earliest date that the level, value or price of each index component that is affected by a market disruption event or by the non-scheduled trading day can be determined. If such a postponement occurs, the level, value or price of the index components unaffected by the market disruption event or non-scheduled trading day will be determined on the scheduled valuation date and the level, value or price of any affected index component will be determined using the settlement level, value or price of that affected index component on the first scheduled trading day following the scheduled valuation date on which no market disruption event occurs or is continuing for that affected index component. In no event, however, will a valuation date be postponed by more than five scheduled trading days. If the calculation agent determines that a market disruption event occurs or is continuing in respect of any index component on the fifth scheduled trading day after the originally scheduled valuation date, the calculation agent will determine the level, value or price for the affected index component in good faith and in a commercially reasonable manner.

If the calculation agent determines that on the initial valuation date a market disruption event occurs or is continuing in respect of any index component or that such day is not a scheduled trading day for any index component, the initial valuation date will be postponed to the earlier of (i) the second scheduled trading day after the originally scheduled initial valuation date and (ii) the earliest date that the level, value or price of each index component that is affected by a market disruption event or by the non-scheduled trading day can be determined. If such a postponement occurs, the level, value or price of the index components unaffected by the market disruption event or occurrence of a non-scheduled trading day will be determined on the scheduled initial valuation date and the level, value or price of any affected index component will be determined using the settlement level, value or price of that affected index component on the first scheduled trading day following the scheduled initial valuation date on which no market disruption event occurs or is continuing for that affected index component. In no event, however, will the initial valuation date be postponed by more than two scheduled trading days. If the calculation agent determines that a market disruption event occurs or is continuing in respect of any index component on the second scheduled trading day after the originally scheduled initial valuation date, the calculation agent will determine the level, value or price for the affected index component in a commercially reasonable manner.

For the purpose of this prospectus supplement and unless otherwise specified in the relevant pricing supplement, "scheduled trading day" with respect to an index composed of commodities means any day on which (1) the calculation agent is scheduled to be open for business in London and New York, and (2) the exchanges on which all index components trade are scheduled to be open for trading, in each case as determined by the calculation agent in its sole discretion.

For securities linked to a basket or to the reference asset with the lowest or highest return in a group of two or more reference assets, if any valuation date is not a scheduled trading day or if the calculation agent determines that a market disruption event occurs or is continuing on any valuation date, that valuation date will be postponed as described under "Reference Assets—Baskets" or "Reference Assets—Least or Best Performing Reference Asset," as applicable.

Adjustments Relating to Securities with an Index as a Reference Asset

If any sponsor discontinues publication of or otherwise fails to publish any index composing the reference asset and that sponsor or another entity publishes a successor or substitute index that the calculation agent determines to be comparable to the discontinued index (that index being referred to herein as a "successor index"), then the level will be determined by reference to the level of that successor index on the date as of which that level is to be determined.

If a successor index is selected by the calculation agent, the successor index will be used as a substitute for the reference asset for all purposes, including for purposes of determining whether a market disruption event exists with respect to that index.

If (1) the index is discontinued or (2) a sponsor fails to publish the index, in either case, prior to (and that discontinuance is continuing on) a valuation date and the calculation agent determines that no successor or substitute index is available at that time, then the calculation agent will determine the value to be used for the level. The value to be used for the level will be computed by the calculation agent in the same general manner previously used by the related sponsor and will reflect the performance of that index through the business day on which that index was last in effect preceding the date of discontinuance. In that case, the calculation agent will treat any business day on which the primary exchange for futures or options contracts relating to that index is open for trading as a business day for that index for purposes of the determination of the final level.

Notwithstanding these alternative arrangements, discontinuance of the publication of any index composing the reference asset may adversely affect the value of, and trading in, the securities.

If at any time, there is:

- a material change in the formula for or the method of calculating the level of the reference asset, an index composing the reference asset, or a successor index;
- a material change in the content, composition or constitution of the reference asset, an index composing the reference asset or a successor index; or
- a change or modification to the reference asset or a successor index such that the reference asset or successor index does not, in the opinion of the calculation agent, fairly represent the value of that reference asset or successor index had those changes or modifications not been made,

then, for purposes of calculating the level of the index, any payments on the securities or making any other determinations as of or after that time, the calculation agent will make those calculations and adjustments as the calculation agent determines may be necessary in order to arrive at a level for the index comparable to that index or that successor index, as the case may be, as if those changes or modifications had not been made, and calculate the amount of interest, payment at maturity and other amounts payable on the note (including the individual inputs thereof), or the amount of money or warrant property payable or deliverable in respect of the warrant, with reference to that index or that successor index, as adjusted.

The calculation agent will make all determinations with respect to adjustments, including any determination as to whether an event requiring adjustment has occurred, as to the nature of the adjustment required and how it will be made. The calculation agent will provide information about any adjustments it makes upon your written request.

Commodities and Commodity Futures Contracts

The principal, interest or any other amounts payable on or any other property deliverable in respect of the notes, and the amount of money or warrant property payable or deliverable in respect of the warrants, may be based on a commodity or futures contracts on a commodity, including level, value or price movements in or other events relating to those commodities. We have no current intention to offer warrants linked to commodities due to regulatory restrictions, and we may also limit the percentage of commodities included in a basket underlying a warrant in order to comply with regulatory restrictions, where applicable.

Commodity Futures Markets

Futures contracts on physical commodities are traded on regulated futures exchanges, and physical commodities and other derivatives on physical commodities and commodity indices are traded in the over-the-counter market and on various types of physical and electronic trading facilities and markets. A futures contract provides for the purchase and sale of a specified type and quantity of a commodity or financial instrument during a stated delivery month for a fixed price. A futures contract provides for a specified settlement month in which the cash settlement is made or in which the commodity or financial instrument is to be delivered by the seller (whose position is therefore described as “short”) and acquired by the purchaser (whose position is therefore described as “long”).

There is no purchase price paid or received on the purchase or sale of a futures contract. Instead, an amount of cash or cash equivalents must be deposited with the broker as “initial margin.” The amount of initial margin may vary depending on the requirements imposed by the exchange clearing houses. The initial margin provides collateral for the obligations of the parties to the futures contract.

By depositing initial margin, which may vary in form depending on the exchange, with the clearing house or broker involved, a market participant may be able to earn interest on the amount of funds deposited, thereby increasing the total return that it may realize from an investment in futures contracts. The market participant normally makes to, and receives from, the exchange subsequent daily payments as the price of the futures contract fluctuates. These payments are called "variation margin" and are made as the existing positions in the futures contract become more or less valuable, a process known as "marking to the market."

Futures contracts are traded on organized exchanges, known as "contract markets" in the United States. At any time prior to the expiration of a futures contract, subject to the availability of a liquid secondary market, a trader may elect to close out its position by taking an opposite position on the exchange on which the trader obtained the position. This operates to terminate the position and fix the trader's profit or loss. Futures contracts are cleared through the facilities of a centralized clearing house and a brokerage firm, referred to as a "futures commission merchant," which is a member of the clearing house. The clearing house guarantees the performance of each clearing member that is a party to a futures contract by, in effect, taking the opposite side of the transaction. Clearing houses do not guarantee the performance by clearing members of their obligations to their customers.

Unlike equity securities, futures contracts, by their terms, have stated expirations and, at a specified point in time prior to expiration, trading in a futures contract for the current delivery month will cease. As a result, a market participant wishing to maintain its exposure to a futures contract on a particular commodity with the nearest expiration must close out its position in the expiring contract and establish a new position in the contract for the next delivery month, a process referred to as "rolling." For example, a market participant with a long position in November crude oil futures that wishes to maintain a position in the nearest delivery month will, as the November contract nears expiration, sell November futures, which serves to close out the existing long position, and buy December futures. This will "roll" the November position into a December position, and, when the November contract expires, the market participant will still have a long position in the nearest delivery month.

Roll yield is generated as a result of holding futures contracts. When longer-dated contracts are priced lower than the nearer contract and spot prices, the market is in "backwardation," and positive roll yield may be generated when higher-priced near-term futures contracts are "sold" to "buy" and hold lower priced longer-dated contracts. When the opposite is true and longer-dated contracts are priced higher than the nearer contracts and spot prices, the market is in "contango," and negative roll yields may result from the "sale" of lower priced near-term futures contracts to "buy" and hold higher priced longer-dated contracts.

Futures exchanges and clearing houses in the United States are subject to regulation by the CFTC. Exchanges may adopt rules and take other actions that affect trading, including imposing speculative position limits, maximum price fluctuations and trading halts and suspensions and requiring liquidation of contracts in some circumstances. Futures markets outside the United States are generally subject to regulation by comparable regulatory authorities. The structure and nature of trading on non-U.S. exchanges, however, may differ from this description.

Settlement Price

Unless otherwise specified in the applicable pricing supplement, the official U.S. dollar cash buyer settlement price (except with respect to German Electricity, which will be the euro cash buyer settlement price) for each commodity will be determined as described below.

(1) where the commodity is gold, the afternoon London Gold price per troy ounce of Gold for delivery in London through a member of the London Bullion Market Association (the "LBMA") authorized to effect that delivery, stated in U.S. dollars, as calculated and administered by independent service provider(s), pursuant to an agreement with the LBMA, and published by the LBMA on its website at www.lbma.org.uk;

(2) where the commodity is silver, the London Silver price per troy ounce of Silver for delivery in London through a member of the LBMA authorized to effect that delivery, stated in U.S. dollars, as calculated and administered by independent service provider(s), pursuant to an agreement with the LBMA, and published by the LBMA on its website at www.lbma.org.uk;

(3) where the commodity is platinum, the afternoon London Platinum price per troy ounce gross of Platinum for delivery in London through a member of the London Platinum and Palladium Market ("LPPM") authorized to effect that delivery, stated in U.S. dollars, as calculated and administered by independent

service provider(s), pursuant to an agreement with the LPPM, and published by the London Metal Exchange ("LME") on its website at www.lme.com;

(4) where the commodity is palladium, the afternoon London Palladium price per troy ounce gross of Palladium for delivery in London through a member of the LPPM authorized to effect that delivery, stated in U.S. dollars, as calculated and administered by independent service provider(s), pursuant to an agreement with the LPPM, and published by the LME on its website at www.lme.com;

(5) where the commodity is aluminium, the official price per tonne of high grade Primary Aluminium on the LME for cash delivery, as stated in U.S. dollars, as determined by the LME;

(6) where the commodity is copper, the official price per tonne of Copper-Grade A on the LME for cash delivery, stated in U.S. dollars, as determined by the LME;

(7) where the commodity is lead, the official price per tonne of Standard Lead on the LME for cash delivery, stated in U.S. dollars, as determined on the LME;

(8) where the commodity is nickel, the official price per tonne of Primary Nickel on the LME for cash delivery, stated in U.S. dollars, as determined by the LME;

(9) where the commodity is tin, the official price per tonne of Tin on the LME for cash delivery, stated in U.S. dollars, as determined by the LME;

(10) where the commodity is zinc, the official price per tonne of Special High Grade Zinc on the LME for cash delivery, as stated in U.S. dollars, as determined by the LME;

(11) where the commodity is WTI Crude, the official settlement price per barrel of West Texas Intermediate Light Sweet Crude Oil on the New York Mercantile Exchange ("NYMEX") of the futures contract in respect of the first nearby month, stated in U.S. dollars, as made public by the NYMEX, provided that if the specified valuation date falls on the last trading day of that futures contract, then the second nearby month futures contract will be used;

(12) where the commodity is Brent Crude, the official settlement price per barrel of Brent Blend Crude Oil on the Intercontinental Exchange's ("ICE") ICE Futures Europe exchange of the futures contract in respect of the first nearby month, stated in U.S. Dollars, as made public by ICE, provided that if the specified valuation date falls on the last trading day of that futures contract, then the second nearby month futures contract will be used;

(13) where the commodity is heating oil, the official settlement price per gallon of NY Harbor ULSD on the NYMEX of the futures contract in respect of the first nearby month, stated in U.S. dollars, as made public by the NYMEX, provided that if the specified valuation date falls on the last trading day of that futures contract, then the second nearby month futures contract will be used;

(14) where the commodity is gas oil, the official settlement price per metric ton of gas oil on ICE Futures Europe of the futures contract in respect of the first nearby month, stated in U.S. dollars, as made public by ICE, provided that if the specified valuation date falls on the last trading day of that futures contract, then the second nearby month futures contract will be used;

(15) where the commodity is jet fuel, the average of high and low of the official published price per metric tonne of jet fuel, stated in U.S. dollars, as published under the heading "FOB Med (Italy): Jet.Av.Fuel" in Platts European, provided that if the specified valuation date falls on the last trading day of that futures contract, then the second nearby month futures contract will be used;

(16) where the commodity is Gasoline RBOB, the official settlement price per gallon of New York Harbor Gasoline Blendstock for Oxygen Blending on the NYMEX of the futures contract in respect of the first nearby month, stated in U.S. Dollars, as made public by the NYMEX, provided that if the specified valuation date falls on the last trading day of that futures contract, then the second nearby month futures contract will be used;

(17) where the commodity is natural gas, the closing settlement price per million British thermal units of natural gas on the NYMEX of the Henry Hub Natural Gas futures contract in respect of the first nearby month, stated in U.S. Dollars, as made public by NYMEX, provided that if the specified valuation date falls on the last trading day of that futures contract, then the second nearby month futures contract will be used;

(18) where the commodity is coal, the official published price per ton of steam coal 6,000 will be as follows: (i) with respect to the specified valuation date falling (a) on a date on which the specified price is published for a calendar month or (b) after a date on which the specified price is published for a calendar month but is on that same calendar month, the specified price per ton of steam coal 6,000 kcal/kg, up to 1% sulphur NAR basis, cif ARA, stated in U.S. Dollars, published under the heading "International Coal Indexes incorporating the API(TM) Indices: Monthly Coal Price Indexes: API 2 (cif ARA)" in the issue of Argus/McCloskey's Coal Price Index Report that reports prices effective for that calendar month; (ii) with respect to a specified valuation date falling during a calendar month, but before a specified price is published for that month, the specified price per ton of steam coal 6,000 kcal/kg, up to 1% sulphur NAR basis, cif ARA, stated in U.S. Dollars, published under the heading "International Coal Indexes incorporating the API(TM) Indices: Monthly Coal Price Indexes: API 2 (cif ARA)" in the issue of Argus/McCloskey's Coal Price Index Report that reports prices effective for the calendar month immediately preceding that specified valuation date;

(19) where the commodity is German Electricity, the official settlement price will be: ELECTRICITY-YEAR PHELIX-FUTURES BASE-EEX meaning that the price for a specified valuation date will be that day's specified valuation date per MWh of base electricity on the EEX of the Futures Contract, stated in euros, published at http://www.eex.com/en, under the headings "Power Derivatives: Derivatives: Germany/Austria (Phelix Futures) Year: Cal-[YEAR]" or any successor headings, that reports prices effective on that specified valuation date. We make no representation or warranty as to the accuracy or completeness of the information displayed on that website, and that information is not incorporated by reference herein and should not be considered a part of this prospectus supplement;

(20) where the commodity is corn, the official U.S. dollar cash buyer settlement price of corn will be the official settlement price per bushel of deliverable grade corn on the Chicago Board of Trade ("CBOT") of the futures contract in respect of either (a) the first nearby month or (b) if the specified valuation date falls after the earlier of (i) the expiration date for the relevant CBOT-traded option with respect to that futures contract or (ii) the last trading day of the futures contract, the second nearby month, stated in U.S. cents, as made public by CBOT;

(21) where the commodity is wheat, the official U.S. dollar cash buyer settlement price of wheat will be the official settlement price per bushel of deliverable grade wheat on the CBOT of the futures contract in respect of either (a) the first nearby month or (b) if the specified valuation date falls after the earlier of (i) the expiration date for the relevant CBOT-traded option with respect to that futures contract or (ii) the last trading day of the futures contract, the second nearby month, stated in U.S. cents, as made public by CBOT;

(22) where the commodity is soybeans, the official U.S. dollar cash buyer settlement price of soybeans will be the official settlement price per bushel of deliverable grade soybeans on the CBOT of the futures contract in respect of either (a) the first nearby month or (b) if the specified valuation date falls after the earlier of (i) the expiration date for the relevant CBOT-traded option with respect to that futures contract or (ii) the last trading day of the futures contract, the second nearby month, stated in U.S. cents, as made public by CBOT;

(23) where the commodity is soybean meal, the official U.S. dollar cash buyer settlement price will be the official settlement price per bushel of deliverable grade soybean meal on the CBOT of the futures contract in respect of either (a) the first nearby month or (b) if the specified valuation date falls after the earlier of (i) the expiration date for the relevant CBOT-traded option with respect to that futures contract or (ii) the last trading day of the futures contract, the second nearby month, stated in U.S. dollars, as made public by CBOT;

(24) where the commodity is sugar, the official settlement price per pound of deliverable grade sugar No. 11 on the NYBOT of the futures contract in respect of either (a) the first nearby month or (b) if the applicable valuation date falls after the earlier of (i) the expiration date for the relevant NYBOT-traded option with respect to that futures contract or (ii) the last trading day of the futures contract, the second nearby month, stated in U.S. cents, as made public by NYBOT;

(25) where the commodity is coffee, the official settlement price per pound of deliverable grade washed arabica coffee on the NYBOT of the futures contract in respect of either (a) the first nearby month or (b) if the applicable valuation date falls after the earlier of (i) the expiration date for the relevant NYBOT-traded option with respect to that futures contract or (ii) the last trading day of the futures contract, the second nearby month, stated in U.S. cents, as made public by NYBOT;

(26) where the commodity is cotton, the official settlement price per pound of deliverable grade cotton No. 2 on the NYBOT of the futures contract in respect of either (a) the first nearby month or (b) if the applicable valuation date falls after the earlier of (i) the expiration date for the relevant NYBOT-traded option with respect to that futures contract or (ii) the last trading day of the futures contract, the second nearby month, stated in U.S. cents, as made public by NYBOT; and

(27) where the commodity is NYBOT cocoa, the official settlement price per metric ton of deliverable grade cocoa beans on the NYBOT of the futures contract in respect of either (a) the first nearby month or (b) if the applicable valuation date falls after the earlier of (i) the expiration date for the relevant NYBOT-traded option with respect to that futures contract or (ii) the last trading day of the futures contract, the second nearby month, stated in U.S. dollars, as made public by NYBOT.

Market Disruption Events for Securities with a Commodity or Commodity Futures Contract as a Reference Asset

Any of the following will be a market disruption event with respect to a commodity or futures contracts relating to that commodity:

- a material suspension of, or material limitation imposed on trading in (1) that commodity that is customarily traded in order to hedge any relevant futures or options contract in its primary market, or (2) futures or options contracts relating to that commodity in the primary market for those contracts;

- the failure by the exchange or price source to announce or publish market values for the commodity or futures or options contracts relating to that commodity or the temporary or permanent discontinuance or unavailability of the price source;

- any event that materially disrupts or impairs, as determined by the calculation agent, the ability of market participants to (1) effect transactions in, or obtain market values for, the commodity in its primary market, or (2) effect transactions in, or obtain market values for, futures or options contracts relating to the commodity in its primary market; or

- any scheduled trading day on which (1) the primary market for that commodity or (2) the exchanges or quotation systems, if any, on which futures or options contracts on that commodity are traded, fail to open for trading during their regular trading session.

For the purpose of this prospectus supplement and unless otherwise specified in the relevant pricing supplement, "scheduled trading day" with respect to a commodity means any day on which (1) the calculation agent is scheduled to be open for business in London and New York, and (2) the relevant primary market on which futures or options contracts related to the commodity are traded is scheduled to be open for trading for its regular trading session, as determined by the calculation agent in its sole discretion.

The following event will not be a market disruption event:

- a decision to permanently discontinue trading in the futures or options contracts relating to the commodity.

  For this purpose, a "suspension of trading" in a commodity, or futures or options contracts related to the commodity, if available, in their primary markets, will be deemed to have occurred where:

- all trading is suspended for the entire scheduled trading day, or
- all trading is suspended and does not recommence with an announcement at least one hour prior to that recommencement.

- a "limitation of trading" in a commodity, or futures or options contracts related to the commodity, if available, in their primary markets will be deemed to have occurred where the relevant primary market establishes limits on the range within which the price of the futures or options contract or the relevant commodity may fluctuate and the closing or settlement price of the futures or options contract or the relevant commodity on that day is at the upper or lower limit of that range.

The calculation agent may postpone any valuation date if the calculation agent determines that the originally scheduled valuation date is not a scheduled trading day or that a market disruption event has occurred or is continuing on a day that would otherwise be that valuation date. Under these circumstances, that valuation date will be the first following scheduled trading day on which the calculation agent determines that no market disruption event occurs or is continuing.

In no event, however, will the initial valuation date be postponed by more than two scheduled trading days nor will any other valuation date be postponed by more than five scheduled trading days. If the calculation agent determines that a market disruption event occurs or is continuing on the second scheduled trading day (in the case of the initial valuation date) or the fifth scheduled trading day (in the case of any other valuation date), the calculation agent will determine the value for the affected commodity in good faith and in a commercially reasonable manner.

For securities linked to a basket or to the reference asset with the lowest or highest return in a group of two or more reference assets, if any valuation date is not a scheduled trading day or if the calculation agent determines that a market disruption event occurs or is continuing on any valuation date, that valuation date will be postponed as described under "Reference Assets—Baskets" or "Reference Assets—Least or Best Performing Reference Asset," as applicable.

Discontinuation of Trading; Alteration of Method of Calculation

If the relevant exchange discontinues trading in, or physical delivery or price discovery of, any commodity, the calculation agent may replace the commodity with another commodity, whose settlement price is quoted on that exchange or any other exchange, that the calculation agent determines to be comparable to the discontinued commodity (a "successor commodity").

If the relevant exchange discontinues trading in, or physical delivery or price discovery of, the commodity composing the reference asset prior to, and the discontinuance is continuing on, any valuation date and the calculation agent determines that no successor commodity is available at that time, then the calculation agent will determine the settlement price for that date.

Notwithstanding these alternative arrangements, discontinuance of trading, physical delivery or price discovery on the applicable exchange in any commodity may adversely affect the market value of the securities.

If at any time (1) the method of calculating the official U.S. dollar cash buyer settlement price of a commodity (or with respect to German Electricity, the euro cash buyer settlement price) is changed in a material respect by the applicable exchange or any other relevant exchange, (2) there is a material change in the composition or constitution of a commodity or (3) the reporting thereof is in any other way modified so that the settlement price does not, in the opinion of the calculation agent, fairly represent the settlement price of the commodity, the calculation agent will, at the close of business in New York City on each scheduled trading day on which the settlement price is to be determined, make those calculations and adjustments as, in the judgment of the calculation agent, may be necessary in order to arrive at a settlement price for the commodity comparable to that commodity or that successor commodity, as the case may be, as if those changes or modifications had not been made, and calculate the amount of interest, payment at maturity and other amounts payable on the note (including the individual inputs thereof), and the amount of money or warrant property payable or deliverable in respect of the warrant, with reference to that commodity or that successor commodity, as adjusted.

Currency Exchange Rates

The principal, interest or any other amounts payable on or any other property deliverable in respect of the notes, and the amount of money or warrant property payable or deliverable in respect of the warrants, may be based on a currency exchange rate or rates, including movements in currency exchange rate levels or other events relating to the currency exchange rates.

To the extent that amounts payable on the notes or amounts of money or warrant property payable or deliverable in respect of the warrants are based on a reference asset composed of one or more of the currency exchange rates, the level with respect to that exchange rate on any day will equal the currency exchange rate as determined by the calculation agent by reference to the mechanics, the Bloomberg page, the Reuters screen or other pricing source and the time specified in the applicable pricing supplement. The screen or time of observation indicated therein in relation to any currency exchange rate will be deemed to refer to that screen or time of observation as modified or amended from time to time, or to any substitute screen thereto.

Market Disruption Events for Securities with a Currency Exchange Rate as a Reference Asset

Any of the following will be a market disruption event where the reference asset is composed of a currency exchange rate or exchanges rates:

- any event or any condition (including without limitation any event or condition that occurs as a result of the enactment, promulgation, execution, ratification, interpretation or application of, or any change in or amendment to, any law, rule or regulation by any applicable governmental authority) that results in an illiquid market for currency transactions or that generally makes it impossible, illegal or impracticable for market participants, or hinders their abilities, (1) to convert from one non-U.S. currency to another through customary commercial channels, (2) to effect currency transactions or (3) to obtain the currency exchange rate by reference to the applicable price source;

- (1) the declaration of a banking moratorium or (2) the suspension of payments by banks, in either case (1) or (2), in the country of any currency used to determine the applicable currency exchange rate or (3) the declaration of capital and/or currency controls (including without limitation any restriction placed on assets in or transactions through any account through which a non-resident of the country of any currency used to determine the applicable currency exchange rate may hold assets or transfer monies outside the country of that currency, and any restriction on the transfer of funds, securities or other assets of market participants from within or outside of the country of any currency used to determine the applicable currency exchange rate),

and, in any of these events, the calculation agent determines that the event was material.

The calculation agent may postpone any valuation date if the calculation agent determines that the originally scheduled valuation date is not a scheduled trading day or that a market disruption event has occurred or is continuing on a day that would otherwise be that valuation date. Under these circumstances, that valuation date will be the first following scheduled trading day (as defined below) on which the calculation agent determines that no market disruption event occurs or is continuing.

In no event, however, will any valuation date be postponed by more than five scheduled trading days. If the calculation agent determines that a market disruption event occurs or is continuing on the fifth scheduled trading day, the calculation agent will determine the currency exchange rate for the currency on that fifth scheduled trading day in good faith and in a commercially reasonable manner.

For the purpose of this prospectus supplement and unless otherwise specified in the relevant pricing supplement, “scheduled trading day” with respect to a currency exchange rate means any day on which (1) the applicable currency exchange rate is scheduled to be reported on the relevant Bloomberg page, Reuters screen or other pricing source specified in the applicable pricing supplement, and (2) the interbank market is scheduled to be open for regular trading, in each case as determined by the calculation agent in its sole discretion.

For securities linked to a basket or to the reference asset with the lowest or highest return in a group of two or more reference assets, if any valuation date is not a scheduled trading day or if the calculation agent determines that a market disruption event occurs or is continuing on any valuation date, that valuation date will be postponed as described under "Reference Assets—Baskets" or "Reference Assets—Least or Best Performing Reference Asset," as applicable.

Adjustments Relating to Securities with a Currency Exchange Rate as a Reference Asset

If the calculation agent determines that (1) any currency underlying a currency exchange rate to which the securities are linked has been removed from circulation or otherwise discontinued and (2) banks dealing in foreign exchange and non-U.S. currency deposits in the underlying currency commence trading a successor or substitute currency or basket of currencies that the calculation agent in its sole discretion (taking into account any applicable treaty provisions, laws or regulations in effect at that time) determines is comparable to the discontinued currency (that currency or basket of currencies being referred to herein as a "successor currency"), then the level for the currency will be determined by reference to the value of the successor currency at the time determined by the calculation agent on the markets for the successor currency on the relevant valuation date.

If the calculation agent determines that any successor currency will be utilized for purposes of calculating the currency exchange rate, or making any other determinations as of or after that time, the calculation agent will make those calculations and adjustments as, in the judgment of the calculation agent, may be necessary in order to arrive at a value of a currency exchange rate for a currency comparable to the underlying currency, as if those changes or modifications had not been made, and will calculate the payment at maturity (including the individual inputs thereof) or the payment or delivery of money or warrant property at the payment or settlement date, and the final level with reference to that currency or the successor currency, as adjusted.

Notwithstanding these alternative arrangements, discontinuance of the publication of the level of any currency underlying the currency exchange rate may adversely affect the value of, and trading in, the securities.

If at any time the method of calculating the level of a currency or a successor currency, or the value thereof, is changed in a material respect, or is in any other way modified so that the conventional market quotation does not, in the opinion of the calculation agent, fairly represent the value of that currency or successor currency had those changes or modifications not been made, then, for purposes of calculating any level, the payment at maturity or on any payment date or making any other determinations as of or after the time of that change, the calculation agent will make those calculations and adjustments as the calculation agent determines may be necessary in order to arrive at a value for that currency comparable to the currency underlying the currency exchange rate or the successor currency, as the case may be, as if those changes or modifications have not been made, and calculate the amount of interest, payment at maturity and other amounts payable on the note (including the individual inputs thereof), or the amount of money or warrant property payable or deliverable in respect of the warrant, with reference to the currency or the successor currency, as adjusted.

Baskets

The principal, interest or any other amounts payable on or any other property deliverable in respect of the notes, and the amount of money or warrant property payable or deliverable in respect of the warrants, may be based on a basket of multiple instruments or measures, including but not limited to equity securities, commodities, currency exchange rates, interest rates, indices of any of the foregoing and/or any combination thereof. Each of those instruments or measures that are included in a basket are referred to as a "basket component."

To the extent that a basket component is composed of an asset type described in this prospectus supplement, see the applicable section under the heading "Reference Assets" for further information that may affect that basket component. Without limiting the generality of the previous sentence, a scheduled trading day and a market disruption event with respect to each basket component are described in the section of this prospectus supplement applicable to that basket component. For example, the "Reference Assets—Equity Securities" section defines "scheduled trading day" with respect to a basket component that consists of an equity security and describes the circumstances under which the calculation agent may determine that there is a market disruption event with respect to a basket component that consists of an equity security.

Scheduled Trading Days and Market Disruption Events for Securities Linked to a Basket of Equity Securities, Exchange-Traded Funds and/or Indices of Equity Securities

Unless otherwise set forth in the applicable pricing supplement, the following provisions will apply to any security linked to a basket of multiple equity securities, exchange-traded funds, indices of equity securities or any combination of equity securities, exchange-traded funds and/or indices of equity securities.

If any valuation date specified in the applicable pricing supplement is not a basket component business day, the scheduled valuation date will be the next following basket component business day. If a market disruption event occurs or is continuing with respect to any basket component on any scheduled valuation date, the valuation date will be postponed to the next following basket component business day on which no market disruption event occurs or is continuing with respect to any basket component; *provided, however*, that the valuation date will not be postponed more than five basket component business days. If a market disruption event occurs or is continuing with respect to any basket component on that fifth basket component business day (the "latest valuation date"), the calculation agent will (i) determine the level or price of any basket component not affected by that market disruption event on the latest valuation date but using the method that would have applied had the valuation date not been postponed and (ii) determine the level or price for any affected basket component in the manner described in the section of this prospectus supplement applicable to that basket component that would apply when a market disruption event occurs or is continuing in respect of that basket component on the latest valuation date.

As used above, the term "basket component business day" means a day that is a scheduled trading day with respect to each basket component. For purposes of the foregoing, the determination of whether (i) a day is a scheduled trading day for any basket component or (ii) a market disruption event has occurred or is continuing with respect to any basket component on any date will be made by the calculation agent in its sole discretion.

Scheduled Trading Days and Market Disruption Events for Securities Linked to a Basket of Any Combination of Assets (Excluding Equity Securities, Exchange-Traded Funds and Indices of Equity Securities)

Unless otherwise set forth in the applicable pricing supplement, the following provisions will apply to any security linked to a basket of multiple indices, commodities, currencies, interest rates, any other assets or any combination of such assets, excluding equity securities, exchange-traded funds and indices of equity securities.

If (i) any valuation date is not a scheduled trading day for any basket component or (ii) a market disruption event occurs or is continuing in respect of any basket component on any valuation date (in either case, a "non-calculation event"), the calculation agent will (i) determine the level, value or price of any basket component not affected by a non-calculation event on the scheduled valuation date in the manner set forth in the applicable pricing supplement and (ii) determine the level, value or price of any affected basket component using the level, value or price of that affected basket component on the first scheduled trading day following the scheduled valuation date on which no market disruption event occurs or is continuing for that affected basket component.

In no event, however, will a valuation date be postponed by more than five scheduled trading days with respect to any basket component. If the calculation agent determines that a market disruption event occurs or is continuing in respect of any affected basket component on the fifth scheduled trading day for that affected basket component after the originally scheduled valuation date (for such affected basket component, the "latest valuation date"), the calculation agent will determine the level, value or price for the affected basket component in the manner described in the section of this prospectus supplement applicable to that basket component that would apply when a market disruption event occurs or is continuing in respect of the affected basket component on the latest valuation date. Notwithstanding the foregoing, for any basket component that is a commodity, commodity futures contract or an index of commodities, the "latest valuation date" with respect to the initial valuation date will be two scheduled trading days after the originally scheduled initial valuation date.

For purposes of the foregoing, the determination of whether (i) a day is a scheduled trading day for any basket component or (ii) a market disruption event has occurred or is continuing with respect to any basket component on any date will be made by the calculation agent in its sole discretion.

Scheduled Trading Days and Market Disruption Events for Securities Linked to a Basket of One or More Equity Securities, Exchange-Traded Funds, Indices of Equity Securities and One or More Other Assets (Excluding Equity Securities, Exchange-Traded Funds and Indices of Equity Securities)

The applicable pricing supplement will set forth the postponement provisions that will apply to any security linked to a basket that includes one or more equity securities, exchange-traded funds or indices of equity securities and one or more other assets that are not equity securities, exchange-traded funds or indices of equity securities.

Adjustments Relating to Securities Linked to a Basket

If the calculation agent substitutes a successor index, successor currency or successor commodity, as the case may be, or otherwise affects or modifies a basket or basket component, the calculation agent will make those calculations and adjustments as, in the judgment of the calculation agent, may be necessary in order to arrive at a basket comparable to the original basket (including without limitation changing the percentage weights of the basket components), as if those changes or modifications had not been made, and will calculate the amount of interest, payment at maturity and other amounts payable or property deliverable on the note (including the individual inputs thereof), or the amount of money or warrant property payable or deliverable in respect of the warrant, with reference to that basket or the successor basket (as described below), as adjusted.

In the event of the adjustment described above, the newly composed basket is referred to herein as the "successor basket" and will be used as a substitute for the original basket for all purposes.

If the calculation agent determines that the available successors as described above do not fairly represent the value of the original basket component or basket, as the case may be, then the calculation agent will determine the level, value or price of the basket component or the basket level for any valuation date as described under "Reference Assets—Indices—Adjustments Relating to Securities with an Index as a Reference Asset" with respect to indices composing the basket component, "Reference Assets—Commodities—Discontinuation of Trading; Alteration of Method of Calculation" with respect to commodities composing the basket component and "Reference Assets—Currency Exchange Rates—Adjustments Relating to Securities with a Currency Exchange Rate as a Reference Asset" with respect to currency exchange rates composing the basket component.

Notwithstanding these alternative arrangements, discontinuance of trading on the applicable exchanges or markets in any basket component may adversely affect the market value of the securities.

If the securities are linked to a basket composed of one or more equity securities, see also "Reference Assets—Equity Securities—Share Adjustments Relating to Securities with an Equity Security as a Reference Asset—Adjustments Affecting Securities Linked to More than One Reference Asset, at Least One of Which Is an Equity Security." If the securities are linked to a basket composed of one or more exchange-traded funds, see also "Reference Assets—Exchange-Traded Funds—Adjustments Relating to Securities with an Exchange-Traded Fund as a Reference Asset—Adjustments Affecting Securities Linked to More than One Reference Asset, at Least One of Which Is an Exchange-Traded Fund."

Least or Best Performing Reference Asset

The principal, interest or any other amounts payable on or any other property deliverable in respect of the notes, and the amount of money or warrant property payable or deliverable in respect of the warrants, may be based on the reference asset with the lowest or highest return in a group of two or more reference assets.

To the extent that one of the assets is an asset type herein described, see the applicable section under the heading "Reference Assets" for further information that may affect that reference asset, and therefore the reference asset for your securities. Without limiting the generality of the previous sentence, a scheduled trading day and a market disruption event with respect to each reference asset will be described in the section of this prospectus supplement applicable to that basket component. For example, the "Reference Assets—Exchange-Traded Funds" section defines scheduled trading day with respect to an exchange-traded fund and describes the circumstances under which the calculation agent may determine that there is a market disruption event with respect to an exchange-traded fund.

Scheduled Trading Days and Market Disruption Events for Securities Linked to the Reference Asset with the Lowest or Highest Return in a Group of Two or More Equity Securities, Exchange-Traded Funds and/or Indices of Equity Securities

If any valuation date specified in the applicable pricing supplement is not a reference asset business day, the scheduled valuation date will be the next following reference asset business day. If a market disruption event occurs or is continuing with respect to any reference asset on any scheduled valuation date, the valuation date will be postponed to the next following reference asset business day on which no market disruption event occurs or is continuing with respect to any reference asset; *provided, however*, that the valuation date will not be postponed more than five reference asset business days. If a market disruption event occurs or is continuing with respect to any reference asset on that fifth reference asset business day (the "latest valuation date"), the calculation agent will (i) determine the level, value or price of any reference asset not affected by that market disruption event on the latest valuation date but using the method that would have applied had the valuation date not been postponed and (ii) determine the level, value or price for any affected reference asset in the manner described in the section of this prospectus supplement applicable to that reference asset that would apply when a market disruption event occurs or is continuing in respect of that reference asset on the latest valuation date.

As used above, the term "reference asset business day" means a day that is a scheduled trading day with respect to each reference asset. For purposes of the foregoing, the determination of whether (i) a day is a scheduled trading day for any reference asset or (ii) a market disruption event has occurred or is continuing with respect to any reference asset on any date will be made by the calculation agent in its sole discretion.

Scheduled Trading Days and Market Disruption Events for Securities Linked to the Reference Asset with the Lowest or Highest Return in a Group of Two or More Reference Assets (Excluding Equity Securities, Exchange-Traded Funds and Indices of Equity Securities)

If (i) any valuation date is not a scheduled trading day for any reference asset or (ii) a market disruption event occurs or is continuing in respect of any reference asset on any valuation date (in either case, a "non-calculation event"), the calculation agent will (i) determine the level, value or price of any reference asset not affected by a non-calculation event on the scheduled valuation date in the manner set forth in the applicable pricing supplement and (ii) determine the level, value or price of any affected reference asset using the level, value or price of that affected reference asset on the first scheduled trading day following the scheduled valuation date on which no market disruption event occurs or is continuing for that affected reference asset.

In no event, however, will a valuation date be postponed by more than five scheduled trading days with respect to any reference asset. If the calculation agent determines that a market disruption event occurs or is continuing in respect of any affected reference asset on the fifth scheduled trading day for that affected reference asset after the originally scheduled valuation date (for such affected reference asset, the "latest valuation date"), the calculation agent will determine the level, value or price for the affected reference asset in the manner described in the section of this prospectus supplement applicable to that reference asset that would apply when a market disruption event occurs or is continuing in respect of the affected reference asset on the latest valuation date. Notwithstanding the foregoing, for any reference asset that is a commodity, commodity futures contract or an index of commodities, the "latest valuation date" with respect to the initial valuation date will be two scheduled trading days after the originally scheduled initial valuation date.

For purposes of the foregoing, the determination of whether (i) a day is a scheduled trading day for any reference asset or (ii) a market disruption event has occurred or is continuing with respect to any reference asset on any date will be made by the calculation agent in its sole discretion.

Scheduled Trading Days and Market Disruption Events for Securities Linked to the Reference Asset with the Lowest or Highest Return in a Group of One or More Equity Securities, Exchange-Traded Funds, Indices of Equity Securities and One or More Other Assets (Excluding Equity Securities, Exchange-Traded Funds and Indices of Equity Securities)

The applicable pricing supplement will set forth the postponement provisions that will apply to any security linked to a the reference asset with the lowest or highest return in a group that includes one or more equity securities, exchange-traded funds or indices of equity securities and one or more other assets that are not equity securities, exchange-traded funds or indices of equity securities.

Reference Asset Information Provider

The securities have not been passed on by the information provider of the reference asset as to their legality or suitability. The securities are not issued, endorsed, sponsored or promoted by and are not financial or legal obligations of the information provider of the reference asset. The trademarks, service marks or registered trademarks of the information provider of the reference asset are the property of their respective owners. The information provider of the reference asset makes no warranties and bears no liabilities with respect to the securities or to the administration or operation of the securities.

Applicable historical data on the reference asset will be provided in the applicable pricing supplement.

The possible "information providers" of the reference assets are Bloomberg screen, Reuters screen or any other information provider as specified in the applicable pricing supplement.

Bloomberg screen

"Bloomberg screen" means, when used in connection with any designated pages, the display page so designated on the Bloomberg Professional® service (or any other page as may replace that page on that service, or any other service as may be nominated as the information vendor).

Reuters screen

"Reuters screen" means, when used in connection with any designated page, the display page so designated on the Thomson Reuters Eikon service (or any other page as may replace that page on that service or successor service for the purpose of displaying rates or prices).

BENEFIT PLAN INVESTOR CONSIDERATIONS

A fiduciary of a pension, profit-sharing or other employee benefit plan subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), including entities such as collective investment funds, partnerships and separate accounts whose underlying assets include the assets of those plans (collectively, "ERISA Plans") should consider the fiduciary standards of ERISA in the context of the ERISA Plan's particular circumstances before authorizing an investment in the securities. Among other factors, the fiduciary should consider whether the investment would satisfy the prudence and diversification requirements of ERISA and would be consistent with the documents and instruments governing the ERISA Plan.

Section 406 of ERISA and Section 4975 of the Internal Revenue Code of 1986, as amended, (the "Code") prohibit ERISA Plans, as well as plans (including individual retirement accounts and Keogh plans) subject to Section 4975 of the Code (together with ERISA Plans, "Plans"), from engaging in certain transactions involving the "plan assets" with persons who are "parties in interest" under ERISA or "disqualified persons" under Section 4975 of the Code (in either case, "Parties in Interest") with respect to those Plans. As a result of our business, we, and our current and future affiliates, may be Parties in Interest with respect to many Plans. Where we (or our affiliate) are a Party in Interest with respect to a Plan (either directly or by reason of our ownership interests in our directly or indirectly owned subsidiaries), the purchase and holding of the securities by or on behalf of the Plan could be a prohibited transaction under Section 406 of ERISA and/or Section 4975 of the Code, unless statutory or administrative exemptive relief were available.

In this regard, certain prohibited transaction class exemptions ("PTCEs") issued by the U.S. Department of Labor may provide exemptive relief for direct or indirect prohibited transactions resulting from the purchase or holding of the securities. Those class exemptions are PTCE 96-23 (for certain transactions determined by in-house asset managers), PTCE 95-60 (for certain transactions involving insurance company general accounts), PTCE 91-38 (for certain transactions involving bank collective investment funds), PTCE 90-1 (for certain transactions involving insurance company separate accounts) and PTCE 84-14 (for certain transactions determined by independent qualified asset managers). In addition, ERISA Section 408(b)(17) and Section 4975(d)(20) of the Code may provide a limited exemption for the purchase and sale of the securities and related lending transactions, provided that neither the issuer of the securities nor any of its affiliates have or exercise any discretionary authority or control or render any investment advice with respect to the assets of the Plan involved in the transaction and provided further that the Plan pays no more, and receives no less, than adequate consideration in connection with the transaction (the so-called "service provider exemption"). There can be no assurance that any of these statutory or class exemptions will be available with respect to transactions involving the securities.

Accordingly, the securities may not be purchased or held by any Plan, any entity whose underlying assets include "plan assets" by reason of any Plan's investment in the entity (a "Plan Asset Entity") or any person investing "plan assets" of any Plan, unless that purchaser or holder is eligible for the exemptive relief available under PTCE 96-23, 95-60, 91-38, 90-1 or 84-14 or the service-provider exemption or there is some other basis on which the purchase and holding of the securities will not constitute a non-exempt prohibited transaction under ERISA or Section 4975 of the Code. Each purchaser or holder of the securities or any interest therein will be deemed to have represented by its purchase or holding of the securities that (a) it is not a Plan or a Plan Asset Entity and its purchase and holding of the securities is not made on behalf of or with "plan assets" of any Plan or a Plan Asset Entity or (b) its purchase and holding of the securities will not result in a non-exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code.

In this regard, certain governmental plans (as defined in Section 3(32) of ERISA), church plans (as defined in Section 3(33) of ERISA) and non-U.S. plans (as described in Section 4(b)(4) of ERISA) ("Non-ERISA Arrangements") are not subject to these "prohibited transaction" rules of ERISA or Section 4975 of the Code, but may be subject to similar rules under other applicable laws or regulations ("Similar Laws"). Accordingly, each such purchaser or holder of the securities will be required to represent (and deemed to have represented by its purchase of the securities) that such purchase and holding will not result in a violation of any applicable Similar Laws.

Due to the complexity of these rules, it is particularly important that fiduciaries or other persons considering purchasing the securities on behalf of or with "plan assets" of any Plan, Plan Asset Entity or Non-ERISA Arrangement consult with their counsel regarding the relevant provisions of ERISA, the Code or applicable Similar Laws and the availability of exemptive relief under PTCE 96-23, 95-60, 91-38, 90-1, 84-14, the service provider exemption or some other basis on which the acquisition and holding will not constitute a non-exempt prohibited transaction under ERISA or Section 4975 of the Code or a violation of any applicable Similar Laws.

The securities are contractual financial instruments. The financial exposure provided by the securities is not a substitute or proxy for, and is not intended as a substitute or proxy for, individualized investment management or advice for the benefit of any purchaser or holder of the securities. The securities have not been designed and will not be administered in a manner intended to reflect the individualized needs and objectives of any purchaser or holder of the securities.

Each purchaser or holder of any securities acknowledges and agrees that:

(i) the purchaser or holder or its fiduciary has made and will make all investment decisions for the purchaser or holder and the purchaser or holder has not relied and will not rely in any way upon us or our affiliates to act as a fiduciary or adviser of the purchaser or holder with respect to (A) the design and terms of the securities, (B) the purchaser or holder's investment in the securities, or (C) the exercise of or failure to exercise any rights we have under or with respect to the securities;

(ii) we and our affiliates have acted and will act solely for our own accounts in connection with (A) all transactions relating to the securities and (B) all hedging transactions in connection with our obligations under the securities;

(iii) any and all assets and positions relating to hedging transactions by us or our affiliates are assets and positions of those entities and are not assets and positions held for the benefit of the purchaser or holder;

(iv) our interests are adverse to the interests of the purchaser or holder; and

(v) neither we nor any of our affiliates is a fiduciary or adviser of the purchaser or holder in connection with any such assets, positions or transactions, and any information that we or any of our affiliates may provide is not intended to be impartial investment advice.

Each purchaser and holder of the securities has exclusive responsibility for ensuring that its purchase, holding and subsequent disposition of the securities does not violate the fiduciary or prohibited transaction rules of ERISA, the Code or any applicable Similar Laws. The sale of any securities to any Plan, Plan Asset Entity or Non-ERISA Arrangement is in no respect a representation by us or any of our affiliates or representatives that such an investment is appropriate for, or meets all relevant legal requirements with respect to investments by, Plans, Plan Asset Entities or Non-ERISA Arrangements generally or any particular Plan, Plan Asset Entity or Non-ERISA Arrangement.

PLAN OF DISTRIBUTION (CONFLICTS OF INTEREST)

Initial Offering and Sale of Securities

Distribution Agreement

We plan to distribute all or part of the securities under the terms of the Amended and Restated Distribution Agreement between us and Barclays Capital Inc., dated February 10, 2009 (the "Amended and Restated Distribution Agreement"), as amended by Amendment No. 1 to the Amended and Restated Distribution Agreement, dated September 14, 2009, and, with respect to the notes only, under the terms of the Accession Agreement between us and Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), dated April 25, 2008 (the "Accession Agreement"). We filed the Amended and Restated Distribution Agreement with the SEC as an exhibit to Form F-3 (File No. 333-145845) on February 10, 2009, Amendment No. 1 to the Amended and Restated Distribution Agreement with the SEC under cover of Form 6-K (File No. 001-10257) on September 14, 2009, and the Accession Agreement with the SEC under cover of Form 6-K (File No. 001-10257) on August 27, 2008.

Pursuant to the distribution arrangements with Barclays Capital Inc. and unless otherwise specified in the relevant pricing supplement, we will issue the securities to Barclays Capital Inc. as principal for its own account in a firm commitment underwriting. In its capacity as principal, Barclays Capital Inc. will subscribe for the securities at a price equal to the issue price specified in the relevant terms sheet or pricing supplement, less any applicable discount, for resale to one or more purchasers at varying prices related to prevailing market prices or at a fixed public offering price.

If specified in the applicable pricing supplement, we may also issue securities to Barclays Capital Inc. as agent, in which case Barclays Capital Inc. will agree or has agreed to use its reasonable efforts to solicit and receive offers to subscribe for the relevant securities from us upon the terms and conditions set forth in the applicable term sheet or pricing supplement. We have the right to accept offers to subscribe for securities and may reject any proposed subscription of the securities. The agent also has the right to reject any offer to subscribe for securities. We will pay Barclays Capital Inc. a commission on any securities distributed through it, which commission will equal the applicable discount on a sale of securities with the same stated term to Barclays Capital Inc. as principal, as described above.

Pursuant to the distribution arrangements with Merrill Lynch, Merrill Lynch, as our agent, has agreed to use its reasonable efforts to solicit and receive offers to subscribe for the relevant securities from us upon the terms and conditions set forth in the applicable term sheet or pricing supplement. We have the right to accept offers to subscribe for securities and may reject any proposed subscription of the securities. The agent may also reject any offer to subscribe for securities. We will pay Merrill Lynch a commission on any securities distributed through it.

We may also issue securities to Merrill Lynch as principal for its own account in a firm commitment underwriting. In that case, Merrill Lynch will subscribe for the securities at a price equal to the issue price specified in the applicable term sheet or pricing supplement, less a discount. The discount will equal the applicable commission on an agency sale of securities with the same stated term.

Barclays Capital Inc. and Merrill Lynch may distribute any securities they purchase as principal to other brokers or dealers at a discount, which may include all or part of the discount the agents received from us. If all the securities are not distributed at the initial issue price, the agents may change the offering price and other subscription terms.

We may appoint distributors under the distribution agreement other than or in addition to Barclays Capital Inc. and Merrill Lynch. Any of these distributors will be acting as our agent and will enter into a distribution agreement substantially in the form referred to above, and the applicable term sheet or pricing supplement will name any of these agents involved in the offering and issue of the securities and any commission that we will pay to them. Agents through whom we distribute securities may enter into arrangements with other institutions with respect to the distribution of the securities, and those institutions may share in the commissions, discounts or other compensation received by our agents, may be compensated separately and may also receive commissions from purchasers for whom they may act as agents. The other agents may be our affiliates or customers and may engage in transactions with and perform services for us in the ordinary course of business. Barclays Capital Inc. may resell securities to or through another of our affiliates, as selling agent.

We may also issue securities to the relevant agent as principal for its own account in a firm commitment underwriting. In that case, the agent will subscribe for the securities at a price equal to the issue price specified in the applicable term sheet or pricing supplement, less a discount. The discount will equal the applicable commission on an agency sale of securities with the same stated term.

The agents may distribute any securities they purchase as principal to other brokers or dealers at a discount, which may include all or part of the discount the agents received from us. If all the securities are not distributed at the initial issue price, the agents may change the offering price and other subscription terms.

Variable Price Offers and Variable Price Reopenings. Securities may be issued at a fixed price (such as par in the case of notes) or as part of a "variable price offer" in which the securities are sold in one or more negotiated transactions (at prices that may be different than par in the case of notes). Sales pursuant to a variable price offer may occur at market prices prevailing at the time of sale, at prices related to those prevailing market prices or at negotiated prices. Notes may be sold at a discount and the redemption price may equal 100% or some other percentage of par. The applicable pricing supplement will specify the issue price or the maximum issue price. Also, from time to time in "variable price reopenings," Barclays Capital Inc. or a third party distributor may purchase and hold some of the securities for subsequent resale at the relevant variable price after the original issue date of the securities.

In addition, in certain variable price offers or variable price reopenings, securities may be offered and sold at variable prices set within a price range as may be specified in the relevant pricing supplement. In situations where Barclays Capital Inc. and one or more third party distributors are distributing the relevant securities at variable prices within such a price range, there may be circumstances where investors may be offered to purchase those securities from one distributor (including Barclays Capital Inc.) at a more favorable price within the price range than from the other distributor(s). Furthermore, from time to time, Barclays Capital Inc. may offer and sell securities to purchasers of a large number of securities at a more favorable price within the price range than a purchaser acquiring a lesser number of securities.

Over-Allotment Option. Unless otherwise specified in the applicable pricing supplement, we may grant agents up to a 30-day over-allotment option from the date of the applicable pricing supplement to purchase or arrange for purchase from us an additional principal amount of notes or an additional number of warrants, as applicable, at the public offering price to cover any over-allotments. The principal amount of notes or number of warrants, as applicable, covered by that option will be specified in the applicable pricing supplement.

Other Arrangements. In addition to subscriptions under the distribution agreement referred to above, we may also distribute all or part of the securities from time to time, on terms determined at that time, through underwriters, dealers and/or agents, directly to purchasers or through a combination of any of these methods of distribution. We describe these other arrangements in "Plan of Distribution" in the accompanying prospectus. We enter into negotiated selected dealer agreements from time to time with certain dealers in connection with these arrangements. We may also engage other firms to provide marketing or promotional services in connection with the distribution of the securities. We will describe any of these arrangements in the applicable pricing supplement.

Settlement. The applicable pricing supplement will specify when the securities will be delivered. Delivery of the securities may be made against payment after the third business day following the date of the applicable pricing supplement, or otherwise as specified by the applicable pricing supplement (for example, if delivery against payment is on the seventh business day, the settlement cycle will be referred to as "T+7"). Under Rule 15c6-1 under the U.S. Securities Exchange Act of 1934, trades in the secondary market generally are required to settle in three business days, unless the parties to the trade expressly agree otherwise. Accordingly, purchasers who wish to trade securities on the date of the applicable pricing supplement will be required, by virtue of the fact that the securities initially will settle, for example, in T+7, to specify an alternative settlement cycle at the time of any such trade to prevent a failed settlement and should consult their own advisor.

Market-Making Resales

This prospectus supplement may be used by Barclays Capital Inc. in connection with offers and sales of the securities in market-making transactions. In a market-making transaction, Barclays Capital Inc. may resell a security it acquires from other holders, after the original offering and distribution of the security. Resales of this kind may occur in the open market or may be privately negotiated, at prevailing market prices at the time of resale or at related

or negotiated prices. In these transactions Barclays Capital Inc. may act as principal, or agent, including as agent for the counterparty in a transaction in which Barclays Capital Inc. acts as principal, or as agent for both counterparties in a transaction in which Barclays Capital Inc. does not act as principal. Barclays Capital Inc. may receive compensation in the form of discounts and commissions, including from both counterparties in some cases. Other affiliates of Barclays Bank PLC may also engage in transactions of this kind and may use this prospectus supplement for this purpose.

The aggregate initial issue price specified on the cover of the accompanying pricing supplement relates to the initial offering of the securities described in the pricing supplement. This amount does not include securities sold in market-making transactions. The latter includes securities to be issued after the date of this prospectus supplement, as well as securities previously issued.

Barclays Bank PLC may receive, directly or indirectly, all or a portion of the proceeds of any market-making transactions by Barclays Capital Inc. and its other affiliates. Fees in connection with possible related swaps and other agreements may need to be described in the applicable pricing supplement depending on the circumstances.

Information about the trade and settlement dates, as well as the purchase price, for a market-making transaction will be provided to the purchaser in a separate confirmation of sale.

Unless we or an agent informs you in your confirmation of sale that your security is being subscribed for in its original offering and issue, you may assume that you are purchasing your security in a market-making transaction.

Conflicts of Interest

Barclays Capital Inc. is an affiliate of Barclays Bank PLC and, as such, will have a "conflict of interest" in any offering in which it participates, as either principal or agent, within the meaning of Rule 5121. Consequently, any such offering will be conducted in compliance with the provisions of Rule 5121. Barclays Capital Inc. is not permitted to sell securities in any such offering to an account over which it exercises discretionary authority without the prior specific written approval of the account holder.

Matters Relating to Initial Offering and Market-Making Resales

Each issue of securities will be a new issue, and there will be no established trading market for any security prior to its original issue date. We do not intend to list any particular issue of securities unless specified in the applicable pricing supplement. We have been advised by Barclays Capital Inc. that it may make a market in the securities, and any underwriters to whom we sell securities for public offering or broker-dealers may also make a market in those securities. However, neither Barclays Capital Inc. nor any underwriter or broker-dealer that makes a market is obligated to do so, and any of them may stop doing so at any time without notice. We cannot give any assurance as to the liquidity of the trading market for the securities.

Unless otherwise indicated in the applicable pricing supplement or confirmation of sale, the subscription price of the securities will be required to be paid in immediately available funds in New York City.

In this prospectus supplement, the accompanying prospectus, and the applicable pricing supplement, the term "this offering" means the initial offering of securities made in connection with their original issuance. This term does not refer to any subsequent resales of securities in market-making transactions.

Non-U.S. Selling Restrictions

General. No action has been or will be taken by Barclays Bank PLC, its affiliates, including but not limited to Barclays Capital Inc., any underwriter, dealer or agent that would permit a public offering of the securities or possession or distribution of this prospectus supplement, the prospectus, any product supplement, any index supplement, any free writing prospectus or the pricing supplement (collectively, the "prospectus" for purposes of this section "Non-U.S. Selling Restrictions") in any jurisdiction, other than the United States, where action for that purpose is required. No offers, sales or deliveries of the securities, or distribution of the prospectus or any other offering material relating to the securities may be made in or from any jurisdiction outside the United States, except in circumstances that will result in compliance with any applicable laws and regulations and will not impose any obligations on Barclays Bank PLC, its affiliates, any underwriter, dealer or agent.

Each underwriter, dealer or agent through which we may offer the securities outside the United States has represented and agreed, or will represent and agree, that it (1) will comply with all applicable laws and regulations in force in each non-U.S. jurisdiction in which it purchases, offers, sells or delivers the securities or possesses or distributes the prospectus and (2) will obtain any consent, approval or permission required by it for the purchase, offer or sale by it of the securities under the laws and regulations in force in each non-U.S. jurisdiction to which it is subject or in which it makes purchases, offers, sales or deliveries of the securities. Barclays Bank PLC will not have responsibility for any compliance by the relevant underwriter, dealer or agent with the applicable laws and regulations or obtaining any required consent, approval or permission.

Argentina. The offering of the securities has not been registered with the Argentine Securities and Exchange Commission (Comisión Nacional de Valores, or the "CNV"). The CNV has neither approved nor disapproved the securities, nor has the CNV passed upon or endorsed the merits of any offering or the accuracy or adequacy of the prospectus. As a result, the securities may not be publicly offered or sold within Argentina, and, accordingly, any transaction involving the securities within Argentina must be done in a manner that does not constitute a public offering or a public distribution of the securities under Argentine laws. The prospectus does not constitute an offer to sell any of the securities referred to therein to any prospective purchaser of the securities in Argentina, nor do they constitute a solicitation of any prospective purchaser of the securities in Argentina of an offer to buy any of the securities referred to therein, under circumstances in which such offer or solicitation (as applicable) would be unlawful.

Aruba. BARCLAYS BANK PLC HAS NOT APPLIED FOR DISPENSATION AS REFERRED TO IN ARTICLE 48 (3) OF THE STATE ORDINANCE ON THE SUPERVISION OF THE CREDIT SYSTEM (*LANDSVERORDENING TOEZICHT KREDIETWEZEN*, OR THE "STATE ORDINANCE") IN RELATION TO THE SECURITIES OFFERED OR TO BE OFFERED UNDER THIS PROSPECTUS. HENCE, THE SECURITIES DESCRIBED HEREIN MAY NOT, DIRECTLY OR INDIRECTLY, BE OFFERED, SOLD, TRANSFERRED OR DELIVERED AS PART OF THEIR INITIAL DISTRIBUTION, OR AT ANY TIME THEREAFTER, IN ARUBA, OTHER THAN TO INDIVIDUALS OR ENTITIES THAT DO NOT QUALIFY AS 'THE PUBLIC' WITHIN THE MEANING OF THE STATE ORDINANCE (I.E. TO (I) THE COUNTRY OF ARUBA, (II) THE CENTRAL BANK OF ARUBA, (III) INSTITUTIONS UNDER INTERNATIONAL PUBLIC LAW IN WHICH THE KINGDOM OF THE NETHERLANDS PARTICIPATES, (IV) ENTERPRISES AND INSTITUTIONS WHICH HAVE BEEN REGISTERED UNDER THE STATE ORDINANCE). HOWEVER, THE SECURITIES DESCRIBED HEREIN MAY WITHOUT REGISTRATION OR AUTHORIZATION OF BARCLAYS BANK PLC UNDER THE STATE ORDINANCE BE OFFERED, SOLD, TRANSFERRED OR DELIVERED TO INDIVIDUALS OR ENTITIES THAT DO QUALIFY AS 'THE PUBLIC' IF THESE SECURITIES ARE OFFERED, SOLD, TRANSFERRED OR DELIVERED TO AN INDIVIDUAL OR ENTITY FOR A TOTAL CONSIDERATION PER OFFER, SALE, TRANSFER OR DELIVERY TO SUCH INDIVIDUAL OR ENTITY OF AT LEAST AFL. 1,000,000 (ONE MILLION ARUBA FLORIN).

Bahamas. The prospectus in connection with the offer of securities by Barclays Bank PLC has not been filed with the Securities Commission of The Bahamas because this offer of securities is exempt from the prospectus filing requirements under the Securities Industry Act 2011. No offer or sale of any securities of Barclays Bank PLC can be made in The Bahamas unless the offer of the securities is made by or through a firm registered with the Securities Commission of The Bahamas to carry on securities business and in compliance with the Bahamian Exchange Control Regulations.

Belize. The prospectus has not been registered in Belize and the securities may not be offered to the general public in Belize.

Bermuda. THE SECURITIES MAY BE OFFERED OR SOLD IN BERMUDA ONLY IN COMPLIANCE WITH THE PROVISIONS OF THE INVESTMENT BUSINESS ACT 2003 AND THE EXCHANGE CONTROL ACT 1972 (AND REGULATIONS MADE THEREUNDER) (THE "EXCHANGE CONTROL ACT") AND THE REQUIREMENTS OF THE RELATED REGULATIONS OF BERMUDA WHICH REGULATE THE SALE OF SECURITIES IN BERMUDA.

Bolivia. This prospectus is intended for informative purposes only. It should not be construed as a contract to engage in any type of transaction with regards to the securities and financial products. This prospectus has been distributed to specific potential clients and should not be construed in any way as a public offering of the securities.

Brazil. The securities have not been, and will not be, registered with the Brazilian Securities Commission (*Comissão de Valores Mobiliários*, or the "CVM"). The securities may not be offered or sold in Brazil, except in circumstances that do not constitute a public offering or unauthorized distribution of securities in Brazil or an undue solicitation of investors under Brazilian laws and regulations. Any documents or other materials relating to any offering of the securities, as well as the information contained herein, may not be supplied in Brazil as part of any public offering, unauthorized distribution or undue solicitation of investors, and may not be used in connection with any offer for subscription, sale, unauthorized distribution of the securities or undue solicitation of investors in Brazil.

British Virgin Islands. The distribution of the prospectus does not constitute a public offer within the meaning of the Securities and Investment Business Act 2010 of the British Virgin Islands, and the prospectus has not been registered with or approved by the Financial Services Commission or any other governmental or regulatory authority in the British Virgin Islands. Notwithstanding that Part II of the Securities and Investment Business Act, 2010 ("SIBA") is not, as at the date of this prospectus, in force, this prospectus shall *not* be distributed to or received by any person in the Virgin Islands if the distribution of this prospectus to or receipt of this prospectus by that person shall constitute an offer of the securities to the public for the purposes of SIBA.

Cayman Islands. No invitation whether directly or indirectly may be made to the public in the Cayman Islands to subscribe for the securities.

Chile. Neither Barclays Bank PLC nor the securities will be registered in the *Registro de Valores Extranjeros* (Foreign Securities Registry) maintained by the *Superintendencia de Valores y Seguros de Chile* (Chilean Securities and Insurance Commission or "SVS") and will not be subject to the supervision of the SVS. If such securities are offered within Chile, they will be offered and sold only pursuant to General Rule 336 of the SVS, an exemption to the registration requirements, or in circumstances which do not constitute a public offer of securities in Chile within the meaning of Article 4 of the Chilean Securities Market Law 18,045. The commencement date of this offering is the one contained in the cover pages of the prospectus. Barclays Bank PLC has no obligation to deliver public information in Chile. These securities shall not be subject to public offering in Chile unless registered in the Foreign Securities Registry.

Barclays Bank PLC y los Valores no serán registrados en el Registro de Valores Extranjeros de la Superintendencia de Valores y Seguros de Chile o 'SVS' y no están sujetos a la fiscalización de la SVS. Si dichos Valores son ofrecidos dentro de Chile, serán ofrecidos y colocados sólo de acuerdo a la Norma de Carácter General 336 de la SVS, una excepción a la obligación de registro, o en circunstancias que no constituyan una oferta pública de valores en Chile según lo definido por el Artículo 4 de la Ley 18.045 de Mercado de Valores de Chile. La fecha de inicio de la presente oferta es la indicada en la portada de el prospecto. El emisor no está obligado a entregar información pública en Chile. Los Valores no podrán ser objeto de oferta pública mientras no sean inscritos en el Registro de Valores Extranjeros de la SVS.

Colombia. The securities have not been, and will not be, registered in the National Securities and Issuers Registry (*Registro Nacional de Valores y Emisores*) of Colombia or traded on the Colombian Stock Exchange (*Bolsa de Valores de Colombia*). Therefore, the securities may not be publicly offered in Colombia or traded on the Colombian Stock Exchange.

The prospectus is for the sole and exclusive use of the addressee as an offeree in Colombia, and the prospectus shall not be interpreted as being addressed to any third party in Colombia or for the use of any third party in Colombia, including any shareholders, administrators or employees of the addressee.

The recipient of the securities acknowledges that certain Colombian laws and regulations (specifically foreign exchange and tax regulations) are applicable to any transaction or investment made in connection with the securities being offered and represents that it is the sole party liable for full compliance with any such laws and regulations.

Costa Rica. The securities are not intended for the Costa Rican public or the Costa Rican market and are not registered, and will not be registered, with the General Superintendence of Securities (the "SUGEVAL") as part of any public offering of securities in Costa Rica. The prospectus relates to an individual, private offering that is made in Costa Rica in reliance upon an exemption from registration with the SUGEVAL pursuant to articles 7 and 8 of the Regulations on the Public Offering of Securities (*Reglamento de Oferta Pública de Valores*). The information contained in the prospectus is confidential, and the prospectus is not to be reproduced or distributed to third parties in Costa Rica.

Curacao. BARCLAYS BANK PLC HAS NOT APPLIED FOR DISPENSATION AS REFERRED TO IN ARTICLE 45(4) OF THE STATE ORDINANCE ON THE SUPERVISION OF BANKING AND CREDIT INSTITUTIONS (*LANDSVERORDENING TOEZICHT BANK - EN KREDIETWEZEN*, OR THE "STATE ORDINANCE") IN RELATION TO THE SECURITIES OFFERED OR TO BE OFFERED UNDER THIS PROSPECTUS. HENCE, THE SECURITIES DESCRIBED HEREIN MAY NOT, DIRECTLY OR INDIRECTLY, BE OFFERED, SOLD, TRANSFERRED OR DELIVERED AS PART OF THEIR INITIAL DISTRIBUTION, OR AT ANY TIME THEREAFTER, IN CURACAO, OTHER THAN TO INDIVIDUALS OR ENTITIES THAT DO NOT QUALIFY AS 'THE PUBLIC' WITHIN THE MEANING OF THE STATE ORDINANCE (I.E. TO INDIVIDUALS OR ENTITIES THAT QUALIFY AS A CREDIT INSTITUTION WITHIN THE MEANING OF ARTICLE 1 OF THE STATE ORDINANCE).

Dominican Republic. Barclays Bank PLC is not an economic agent under the definitions of Law 19-00. The prospectus does not constitute a Public Offer of Securities under Stock Market Law 19-00, Decree Number 664-12, and the regulations and directives approved by the Superintendence of Securities, and the National Securities Council. Therefore Barclays Bank PLC is not subject to the registration procedure or bound by the disclosure of relevant information requirements established in the aforementioned regulation.

El Salvador. The recipient of the prospectus acknowledges that the prospectus has been provided by Barclays Bank PLC upon the recipient's request and under a private placement of securities.

European Economic Area. In relation to each member state of the European Economic Area which has implemented the Prospectus Directive (each a "Relevant Member State"), each underwriter, dealer or agent in connection with an offering of securities has represented and agreed that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the "Relevant Implementation Date") it has not made and will not make an offer of securities which are the subject of the offering contemplated by this prospectus to the public in that Relevant Member State except that, with effect from and including the Relevant Implementation Date, an offer of such securities may be made to the public in that Relevant Member State:

(a) if Barclays Bank PLC expressly specifies that an offer of those securities may be made other than pursuant to Article 3(2) of the Prospectus Directive in that Relevant Member State (a 'Public Offer'), following the date of publication of a prospectus in relation to such securities which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, provided that any such prospectus has subsequently been completed by the final terms contemplating such Public Offer, in accordance with the Prospectus Directive, in the period beginning and ending on the dates specified in such prospectus or final terms, as applicable, and Barclays Bank PLC has consented in writing to its use for the purpose of that Public Offer;

(b) to any legal entity which is a qualified investor as defined in the Prospectus Directive;

(c) at any time to fewer than 150 natural or legal persons (other than qualified investors as defined in the Prospectus Directive), subject to obtaining the prior consent of the relevant underwriters, dealers or agents for any such offer; or

(d) at any time in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of securities referred to in (b) to (d) above shall require the Barclays Bank PLC or any underwriter, dealer or agent to publish a prospectus pursuant to Article 3 of the Prospectus Directive, or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provision, the expression 'an offer of securities to the public' in relation to any securities in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the securities to be offered so as to enable an investor to decide to purchase or subscribe for the securities, as the same may be varied in that Relevant Member State by any measure implementing the Prospectus Directive in that Relevant Member State and the expression **"Prospectus Directive"** means Directive 2003/71/EC of the European Parliament and of the Council (as amended, including by Directive 2010/73/EU).

Each underwriter, dealer or agent in connection with an offering of securities will be required to represent and agree, that any commission or fee received from Barclays Bank PLC complies with the applicable rules set out in the Markets in Financial Instruments Directive 2004/39/EC.

Guatemala. This communication and any accompanying information (the "Materials") are intended solely for informational purposes and do not constitute (and should not be interpreted to constitute) the offering, selling, or conducting of business with respect to such securities, products or services in the jurisdiction of the addressee (this "Jurisdiction"), or the conducting of any brokerage, banking or other similarly regulated activities ("Financial Activities") in this Jurisdiction. Neither Barclays Bank PLC nor the securities, products and services described herein are registered (or intended to be registered) in this Jurisdiction. Furthermore, neither Barclays Bank PLC nor the securities, products, services or activities described herein are regulated or supervised by any governmental or similar authority in this Jurisdiction. The Materials are private, confidential and are provided by Barclays Bank PLC only for the exclusive use of the addressee. The Materials must not be publicly distributed and any use of the Materials by anyone other than the addressee is not authorised. The addressee is required to comply with all applicable laws in this Jurisdiction, including, without limitation, tax laws and exchange control regulations, if any.

Honduras. This communication and accompanying materials are intended solely for informational purposes and do not constitute (and should not be interpreted to constitute) the offering, selling, or conducting of business with respect to such securities, products or services in the jurisdiction of the addressee, or the conducting of any banking, brokerage, investment advisory or other similarly regulated activities in this jurisdiction. Neither Barclays Bank PLC nor the products, services or securities described herein are registered (or intended to be registered) in this jurisdiction. Furthermore, neither Barclays Bank PLC nor the products, services, securities or activities described herein are regulated or supervised by any governmental or similar authority in this jurisdiction. The information provided is private, confidential and is provided by Barclays Bank PLC only for the exclusive use of the addressee. The materials must not be publicly distributed and any use of them by anyone other than the addressee is not authorised. The addressee is required to comply with all applicable laws in this jurisdiction, including, without limitation, tax laws and exchange control regulations, if any.

Mexico. The securities have not been, and will not be, registered with the National Securities Registry maintained by the Mexican National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*) and, therefore, the securities may not be publicly offered or sold nor be the subject of intermediation in Mexico, publicly or otherwise, except that the securities may be offered in Mexico to institutional and qualified investors pursuant to the private placement exception set out in Article 8 of the Mexican Securities Market Law.

Nicaragua. The securities offered in this document are only available to determined customers known by the distributor, and which have suitable financial situation, risk tolerance, and sophistication as determined at the sole discretion of the distributor. The securities offered in this document may not be offered or sold publicly in Nicaragua.

Panama. The securities have not been, and will not be, registered with the Superintendence of Capital Markets (the "SCM") under Decree Law No. 1 of 8 July 1999 and Law 67 of 1 September 2011 and its regulations (the "Panamanian Securities Act") and may not be publicly offered or sold within Panama, except in certain limited transactions exempted from the registration requirements of the Panamanian Securities Act. The securities do not benefit from the tax incentives accorded to registered securities by the Panamanian Securities Act and are not subject to regulation or supervision by the SCM.

Paraguay. This does not constitute a public offering of securities or other financial products and services in Paraguay. You acknowledge that the securities and financial products offered herein were issued outside of Paraguay. You acknowledge that any legal matter arising from any offering of the securities shall not be submitted to any Paraguayan government authority. You acknowledge that the Paraguayan Deposit Insurance legislation does not insure investments in the offered securities. The Paraguayan Central Bank (*Banco Central del Paraguay*), the Paraguayan National Stock Exchange Commission (*Comisión Nacional de Valores del Paraguay*) and the Paraguayan Banking Superintendence (*Superintendencia de Bancos del Banco Central del Paraguay*) do not regulate any offering of the securities or any obligations that may arise from such offering. You should make your own decision whether any offering meets your investment objectives and risk tolerance level.

Esta oferta no constituye el ofrecimiento público de valores u otros productos y servicios financieros en Paraguay. Ud. reconoce que los valores y los productos financieros ofrecidos por este medio fueron emitidos fuera del Paraguay. Ud. acepta que cualquier disputa o conflicto legal que surja en virtud de esta oferta no será sometida a autoridad pública Paraguaya alguna. Asimismo, Ud. reconoce que la Ley de Garantía de Depósitos de su país de residencia no cubre los productos ofrecidos por este medio, ni los activos y fondos transferidos a estos efectos. El Banco Central del Paraguay, la Comisión Nacional de Valores del Paraguay, y la Superintendencia de Bancos del Banco Central del Paraguay no regulan ni son responsables de la oferta de estos productos o su aceptación. Ud. debe evaluar si la presente oferta cumple con sus objetivos de inversión y niveles de tolerancia de riesgos.

Peru. General Notice for Private Offer: The securities and the information contained in this prospectus have not been, and will not be, registered with or approved by the Peruvian Capital Markets Superintendency (*Superintendencia del Mercado de Valores* or "SMV") or the Lima Stock Exchange (*Bolsa de Valores de Lima* or "BVL"). Accordingly, the securities cannot be offered or sold in Peru, except if such offering is considered a private offering under the securities laws and regulations of Peru. The Peruvian securities market law establishes, among other things, that any particular offer may qualify as private if it is directed exclusively to institutional investors.

Notice to Private Pension Funds and Insurance Companies in Peru: Private Pension Funds (*Administradoras Privadas de Fondos de Pensiones*) and Insurance Companies (*Compañías de Seguros*) in Peru should seek their own legal advice as to the eligibility of the securities and legal, financial and technical advice as to their capacity to acquire the securities in compliance with the limits set out by applicable Peruvian law. In particular, to acquire securities that incorporate derivatives or alternative funds in their structure, Peruvian Private Pension Funds should seek to register the securities with the Foreign Investment and Derivative Instruments Registry (*Registro de Instrumentos de Inversión y Operaciones de Cobertura de Riesgo Extranjeros*) of the Peruvian Banking, Insurance and Private Pension Fund Administrators Superintendency (*Superintendencia de Banca, Seguros y Administradoras Privadas de Fondos de Pensiones* or "SBS"), in order to make the securities eligible for investment by such entities, as required by Peruvian law.

Other institutional investors, as defined by Peruvian legislation, must rely on their own examination of the terms of the offering of the securities to determine their ability to invest in them.

Sint Maarten. BARCLAYS BANK PLC HAS NOT APPLIED FOR DISPENSATION AS REFERRED TO IN ARTICLE 45 (2) OF THE STATE ORDINANCE ON THE SUPERVISION OF BANKING AND CREDIT INSTITUTIONS (*LANDSVERORDENING TOEZICHT BANK- EN KREDIETWEZEN*, OR THE "STATE ORDINANCE") IN RELATION TO THE SECURITIES OFFERED OR TO BE OFFERED UNDER THIS PROSPECTUS. HENCE, THE SECURITIES DESCRIBED HEREIN MAY NOT, DIRECTLY OR INDIRECTLY, BE OFFERED, SOLD, TRANSFERRED OR DELIVERED AS PART OF THEIR INITIAL DISTRIBUTION OR AT ANY TIME THEREAFTER, IN SINT MAARTEN, OTHER THAN TO INDIVIDUALS OR ENTITIES THAT DO NOT QUALIFY AS 'THE PUBLIC' WITHIN THE MEANING OF THE STATE ORDINANCE (I.E. TO INDIVIDUALS OR ENTITIES THAT QUALIFY AS A CREDIT INSTITUTION WITHIN THE MEANING OF ARTICLE 1 OF THE STATE ORDINANCE).

United Kingdom. Any offeror of the securities will be required to represent and agree that:

(a) *Financial Promotion:* it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) received by it in connection with the issue or sale of any securities in circumstances in which section 21(1) of the FSMA would not, if it was not an authorized person, apply to Barclays Bank PLC;

(b) *General Compliance:* it has complied and will comply with all applicable provisions of the FSMA and the Financial Conduct Authority Handbook with respect to anything done by it in relation to any securities in, from or otherwise involving the United Kingdom.

(c) *Commissions and fees:*

(i) if it is distributing securities that are 'retail investment products' (as such term is defined in the Financial Conduct Authority Handbook) into the United Kingdom and it is entitled to receive any commission or fee from Barclays Bank PLC, it will not transfer any part of that commission or fee to any third party who may advise retail investors to purchase a security that is a retail investment product; and

(ii) if it is authorized and regulated by the Financial Conduct Authority to provide investment advice to retail investors in the United Kingdom and it is providing advice to retail investors in respect of a security that is a retail investment product, it undertakes not to request any commission or fee from Barclays Bank PLC and to otherwise reject any such payment offered to it other than in circumstances where Barclays Bank PLC has agreed to facilitate the payment of an advisory fee and has the express consent of the retail investor to do so.

Uruguay. The sale of the securities qualifies as a private placement pursuant to section 2 of Uruguayan law 18.627. Each distributor of the securities represents and agrees that it has not offered or sold, and will not offer or sell, any securities to the public in Uruguay, except in circumstances which do not constitute a public offering or distribution under Uruguayan laws and regulations. The securities are not and will not be registered with the Central Bank of Uruguay to be publicly offered in Uruguay.

In the case of funds: The securities correspond to investment funds that are not investment funds regulated by Uruguayan law 16,774 dated 27 September 1996, as amended.

Venezuela. Pursuant to the Venezuelan Securities Market Act, no public offering of securities can be made in the country without the prior authorization from, and registration with, the National Securities Superintendency (*Superintendencia Nacional de Valores*). There is no such authorization or registration with regards to this document and there is no intention to make a public offering of securities in Venezuela.

USE OF PROCEEDS AND HEDGING

We will use the net proceeds we receive from the issue and subscription of the securities for general corporate purposes. We or our affiliates may also use those proceeds in transactions intended to hedge our obligations under the securities as described below.

On or prior to the issue and subscription of the securities, we or our affiliates expect to enter into hedging transactions to hedge some or all of our anticipated exposure by, for example, taking or modifying positions in the reference assets and listed or over-the-counter options on the reference assets. From time to time, we or our affiliates may enter into additional hedging transactions or unwind those we have entered into.

In this regard, we or our affiliates may, throughout the life of the securities:

- acquire or dispose of long or short positions in listed or over-the-counter options, futures or other instruments linked to the reference asset,
- acquire or dispose of long or short positions in components of the reference assets,
- acquire or dispose of long or short positions in listed or over-the-counter options, futures or other instruments designed to track the performance of the reference assets or their components, or
- any other transaction or arrangement.

We or our affiliates may acquire a long or short position in securities similar to the securities from time to time and may, in our or their sole discretion, hold or resell those securities.

We or our affiliates may close out our or their hedge on or before the final valuation date. That step may involve sales or purchases of some or all of the components of the reference asset, or listed or over-the-counter options, futures or other instruments linked to the reference assets or their components.

The hedging activity discussed above may adversely affect the market value of the securities from time to time. See "Risk Factors" in this prospectus supplement for a discussion of these adverse effects.

MATERIAL U.S. FEDERAL INCOME TAX CONSEQUENCES

The following discussion supersedes the discussion set forth in "Tax Considerations—U.S. Taxation" in the accompanying prospectus. The following is a general discussion of material U.S. federal income tax consequences of the ownership and disposition of notes. It applies to you if you are an initial investor in notes that holds them as capital assets within the meaning of Section 1221 of the Internal Revenue Code of 1986, as amended (the "Code"). This discussion does not address all aspects of U.S. federal income taxation that may be relevant to you in light of your particular circumstances, including alternative minimum tax consequences and the application of the "Medicare contribution tax" on investment income, as well as the different consequences that may apply if you are subject to special treatment under the U.S. federal income tax laws, such as:

- a financial institution;
- an insurance company;
- a "regulated investment company" as defined in Code Section 851;
- a "real estate investment trust" as defined in Code Section 856;
- a tax-exempt entity, including an "individual retirement account" or "Roth IRA" as defined in Code Section 408 or 408A, respectively;
- a dealer in securities;
- a person holding a note as part of a hedging transaction, "straddle," conversion transaction or integrated transaction, or who has entered into a "constructive sale" with respect to a note;
- a U.S. Holder (as defined below) whose functional currency is not the U.S. dollar;
- a former citizen or resident of the United States;
- a trader in securities who elects to apply a mark-to-market method of tax accounting; or
- a partnership or other entity classified as a partnership for U.S. federal income tax purposes.

If you are a partnership for U.S. federal income tax purposes, the U.S. federal income tax treatment of your partners will generally depend on the status of the partners and your activities.

We will not attempt to ascertain whether any entity the stock of which either is or is included in a reference asset would be treated as a "passive foreign investment company" (a "PFIC") within the meaning of Code Section 1297 or as a "United States real property holding corporation" (a "USRPHC") within the meaning of Code Section 897. If any such entity were so treated, certain adverse U.S. federal income tax consequences might apply, to a U.S. Holder (as defined below) in the case of a PFIC, or to a Non-U.S. Holder (as defined below) in the case of a USRPHC, upon the sale, exchange or retirement of the notes. You should refer to information filed by such entities with the Securities and Exchange Commission or an equivalent governmental authority and consult your tax advisor regarding the possible consequences to you if any such entity is or becomes a PFIC or a USRPHC.

This discussion is based on the Code, administrative pronouncements, judicial decisions and final, temporary and proposed Treasury regulations as of the date of this prospectus supplement, all of which are subject to change, possibly with retroactive effect. The effects of any applicable state, local, or foreign tax laws are not discussed. **You should consult your tax advisor concerning the application of U.S. federal income and estate tax laws to your particular situation (including the possibility of alternative treatments of your notes), as well as any tax consequences arising under the laws of any state, local or foreign jurisdiction.**

This discussion does not address the U.S. federal income tax consequences of the ownership or disposition of any reference asset or other property that you may receive at maturity or otherwise pursuant to the terms of your notes. You should consult your tax advisor regarding the potential U.S. federal income tax consequences of the ownership and disposition of any reference asset. This discussion also does not address notes linked to one or more foreign currencies (other than certain notes denominated in a foreign currency), the tax treatment of which will be specified in the applicable pricing supplement. In addition, the discussion does not address the tax consequences of the purchase, beneficial ownership and disposition of warrants, the consequences of which will be described in the applicable pricing supplement.

Tax Treatment of the Notes

The tax treatment of the notes for U.S. federal income tax purposes will depend upon the facts at the time of the relevant offering. At the time of the relevant offering, we may seek an opinion of counsel regarding the tax consequences of the ownership and disposition of the notes. In this event, whether or not counsel is able to opine regarding the correctness of the treatment we intend to apply to a particular offering of notes, we generally expect that counsel will be able to opine that the tax consequences described in the applicable sections below are the relevant tax consequences of owning and disposing of the notes if that treatment is respected, and to describe certain tax consequences that may apply if it is not respected.

The following discussion assumes the treatment described in the applicable section below is respected, except where otherwise indicated. The relevant pricing supplement may indicate other issues applicable to a particular offering of notes.

Tax Consequences to U.S. Holders

The following discussion applies to you if you are a "U.S. Holder" of a note. You are a "U.S. Holder" if for U.S. federal income tax purposes you are a beneficial owner of a note that is:

- a citizen or individual resident of the United States;
- a corporation or other entity taxable as a corporation created or organized under the laws of the United States, any state therein or the District of Columbia; or
- an estate or trust the income of which is subject to U.S. federal income taxation regardless of its source.

Notes Treated as Indebtedness for U.S. Federal Income Tax Purposes

The following discussion applies to notes properly treated as indebtedness for U.S. federal income tax purposes, and so will not apply to notes described below under "—Notes Treated as Prepaid Forward or Derivative Contracts," "—Notes Treated as Prepaid Income-Bearing Forward or Derivative Contracts," "—Notes Treated as Prepaid Forward or Derivative Contracts with Associated (Contingent) Coupons," and "—Notes Treated as Put Options and Deposits," or if otherwise stated in an applicable pricing supplement.

The relevant pricing supplement will indicate whether we intend to treat your notes as "OID Notes," "VRDIs," "CPDI Notes," or "foreign currency notes," and may also disclose our or our counsel's comfort on this treatment (if any), as well as possible alternative treatments.

Notes with a Term of Not More than One Year

The following discussion applies to notes with a term of not more than one year (including either the issue date or the last possible date that the notes could be outstanding pursuant to their terms, but not both), to which we refer as "short-term obligations." The following discussion does not apply to short-term obligations denominated in a specified currency other than the U.S. dollar, the tax treatment of which will be described in the relevant pricing supplement.

Generally, a short-term obligation is treated for U.S. federal income tax purposes as issued at a discount equal to the difference between the payments due thereon and the instrument's issue price, and this discount is treated as interest income when received or accrued, in accordance with your method of tax accounting. There is no authority, however, regarding the accrual of discount on short-term obligations that provide for contingent payments, and no ruling will be requested from the IRS with respect to these notes. As a result, several aspects of the U.S. federal income tax consequences of an investment in these notes are uncertain, as discussed below.

Tax Treatment Prior to Maturity. If you are a cash-method holder, you will not be required to recognize income with respect to the notes prior to maturity, other than with respect to amounts received as stated interest, if any, or received pursuant to a sale or exchange, as described below. You may, however, elect to accrue discount into income on a current basis, in which case you would be subject to the rules described in the following paragraph. Generally, a cash-method owner of a short-term obligation that does not make this election is required to defer deductions with respect to any interest paid on indebtedness incurred to purchase or carry the short-term obligation, to the extent of accrued discount that the owner has not yet included in income (or accounted for in connection with a sale or exchange of the obligation). As noted above, however, there is no authority regarding the accrual of discount on short-term obligations such as the notes. It is therefore unclear how, if at all, the rules regarding deferral of interest deductions would apply to your notes.

Generally, accrual-method owners and certain other owners of a short-term obligation (including electing cash-method owners) are required to accrue discount on the obligation into income on a straight-line basis, unless they elect to accrue the discount on a constant-yield basis based on a compounding of interest. As noted above, however, there is no authority regarding the accrual of discount on short-term obligations such as the notes. Consequently, the timing and amounts of the discount to be accrued on these notes is generally unclear. If the overall amount of discount that will be received has become fixed (or the likelihood of this amount not being a fixed amount has become remote) prior to maturity, it is likely that the amount of discount to be accrued will be determined based on the fixed amount.

Tax Treatment upon Sale, Exchange or Redemption. Upon a sale or exchange of a note (including redemption at maturity), you will recognize gain or loss in an amount equal to the difference between the amount you receive and your adjusted basis in the note. Your adjusted basis in the note will equal the amount you paid to acquire the note, increased by any discount that you have previously included in income but not received. The amount of any resulting loss will be treated as a capital loss. A loss may be subject to special reporting requirements if it exceeds certain thresholds, although this is unclear. Gain resulting from redemption at maturity should be treated as ordinary interest income.

Generally, in the case of a cash-method owner of a short-term obligation who has not elected an accrual method of accounting, gain recognized on a sale or exchange prior to maturity is treated as ordinary interest income in an amount not exceeding the accrued but unpaid discount. As noted above, however, there is no authority regarding the accrual of discount on short-term obligations such as the notes. If the overall amount of discount that will be received at maturity has become fixed (or the likelihood of this amount not being a fixed amount has become remote) prior to the sale or exchange, it is likely that the portion of a cash-method U.S. Holder's gain on the sale or exchange that will be treated as accrued discount (and, therefore, taxed as interest income) will be determined based on the fixed amount. If you are a cash-method U.S. Holder, any portion of gain attributable to fixed but unpaid stated interest will be treated as interest income to you.

Generally, in the case of an owner that is subject to an accrual method of accounting, gain recognized on a sale or exchange of a short-term obligation will be short-term capital gain, because accrued discount will already have been included in the owner's income. As noted above, however, there is no authority regarding the accrual of discount on short-term obligations such as the notes. Consequently, there is uncertainty regarding what portion, if any, of gain recognized upon the sale or exchange of a note prior to maturity by a U.S. Holder subject to an accrual method of accounting will be treated as short-term capital gain. Notwithstanding this uncertainty, if you are subject to an accrual method of accounting, you will recognize interest income no later than, and in an amount not less than, if the notes were subject to cash-method accounting.

Notes with a Term of More than One Year

If the term of the notes (including either the issue date or the last possible date that the notes could be outstanding pursuant to their terms, but not both) is more than one year, the following discussion applies.

We expect to treat notes with a term of more than one year that provide for interest payments at least annually at a variable rate as either "contingent payment debt instruments" or "variable rate debt instruments," depending on the terms of the particular offering. In either case, we expect that there will be some risk that the Internal Revenue Service ("IRS") could determine that our treatment of these notes was incorrect. For example, if we treat notes as variable rate debt instruments, we expect that there will be some risk that the IRS could determine that they were in fact contingent payment debt instruments, or *vice versa*. Any such determination could have adverse U.S. federal income tax consequences for you.

The tax consequences of notes properly treated as "contingent payment debt instruments" are described exclusively in the section entitled "—Contingent Payment Debt Instruments," below.

Payments of Interest

Interest paid on the notes will be taxable to you as ordinary income at the time it accrues or is received in accordance with your method of tax accounting, provided that the interest is "qualified stated interest" (as defined below under "—Original Issue Discount Notes"). Special rules apply to the treatment of interest paid with respect to certain notes, as described under "—Original Issue Discount Notes," "—Foreign Currency Notes," and "—Variable Rate Debt Instruments," below.

Original Issue Discount Notes

A note that has an "issue price" that is less than its "stated redemption price at maturity" will be considered to have been issued with original issue discount ("OID") for federal income tax purposes unless the note satisfies a *de minimis* threshold (as described below). We refer to these notes as "OID Notes."

The "issue price" of a note will be the first price at which a substantial amount of the notes is sold to the public (not including sales to bond houses, brokers or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The "stated redemption price at maturity" of a note generally will equal the sum of all payments required under the note other than payments of "qualified stated interest." "Qualified stated interest" is stated interest unconditionally payable in cash or in property (other than in debt instruments of the issuer) at least annually during the entire term of the note and equal to the outstanding principal balance of the note multiplied by a single fixed rate of interest. In addition, qualified stated interest includes, among other things, stated interest on a "variable rate debt instrument" that is unconditionally payable at a single qualified floating rate of interest or at a rate that is (among other things) determined pursuant to a single fixed formula based on objective financial or economic information. A rate generally is a qualified floating rate if variations in the rate can reasonably be expected to measure contemporaneous fluctuations in the cost of newly borrowed funds in the currency in which the note is denominated.

If the difference between a note's stated redemption price at maturity and its issue price is less than a *de minimis* amount, *i.e.*, generally, 1/4 of 1% of the stated redemption price at maturity multiplied by the number of complete years from issuance to maturity (or, in certain circumstances, the weighted average maturity), the note will not be considered to have OID. If you hold notes with a *de minimis* amount of OID, you will include this OID in income, as capital gain, on a *pro rata* basis as principal payments are made on the notes.

You will be required to include OID in income for federal income tax purposes as it accrues in accordance with a constant-yield method based on a compounding of interest, regardless of whether cash attributable to this income is received. Under this method, you generally will be required to include in income increasingly greater amounts of OID in successive accrual periods.

You may make an election to include in gross income all interest that accrues on any note treated as indebtedness (including stated interest, acquisition discount, OID, *de minimis* OID, market discount, *de minimis* market discount and unstated interest, as adjusted by any amortizable bond premium or acquisition premium) in accordance with a constant-yield method based on a compounding of interest (a "constant-yield election").

Optional Redemptions

We may have an unconditional option to redeem, or holders may have an unconditional option to require us to redeem, a note prior to its stated maturity date. Under applicable regulations, if we have an unconditional option, or holders have an unconditional option to require us, to redeem a note prior to its stated maturity date, this option will be presumed to be exercised or not exercised if, by utilizing any date on which the note may be redeemed as the maturity date and the amount payable on that date in accordance with the terms of the note as the stated redemption price at maturity, the yield on the note would be lower (in case of our option) or higher (in case of a holder's option) than its yield to maturity. If an option is not in fact exercised contrary to the above-described assumptions, the note will be treated solely for purposes of calculating OID as if it were redeemed, and a new note will be treated as issued, on the presumed exercise (or non-exercise) date for an amount equal to the note's adjusted issue price on that date. The adjusted issue price of an OID note is defined as the sum of the issue price of the note and the aggregate amount of previously accrued OID, less any prior payments other than payments of qualified stated interest.

Market Discount

If you purchase a note for an amount that is less than its stated redemption price at maturity or, in the case of an OID Note or OID VRDI Note (as defined herein under "—Variable Rate Debt Instruments"), its adjusted issue price, the amount of the difference will be treated as market discount for federal income tax purposes, unless this difference is less than a specified *de minimis* amount.

You will be required to treat any principal payment (or, in the case of an OID Note or OID VRDI Note, any payment that does not constitute qualified stated interest) on, or any gain on the sale, exchange or redemption of a note, including disposition in certain nontaxable transactions, as ordinary income to the extent of the market discount accrued on the note at the time of the payment, sale, exchange or redemption unless this market discount has been previously included in income pursuant to an election to include market discount in income as it accrues, or pursuant to a constant-yield election as described under "—Original Issue Discount Notes" above. If the note is disposed of in one of certain nontaxable transactions, accrued market discount will be includible as ordinary income as if you had sold the note in a taxable transaction at its then fair market value. Unless you elect to include market discount in income as it accrues, you generally will be required to defer deductions with regard to any interest paid on indebtedness incurred to purchase or carry the notes in an amount not exceeding the accrued market discount that has not yet been included in income.

If you make a constant-yield election for a note with market discount, that election will result in a deemed election for all market discount bonds acquired on or after the first day of the first taxable year to which that election applies.

Acquisition Premium and Amortizable Bond Premium

If you purchase a note for an amount that is greater than the note's adjusted issue price but less than or equal to the sum of all amounts payable on the note after the purchase date, other than payments of qualified stated interest, you will be considered to have purchased the note at an acquisition premium. Under the acquisition premium rules, the amount of OID that you must include in gross income with respect to the note for any taxable year will be reduced by the portion of acquisition premium properly allocable to that year.

If you purchase a note for an amount that exceeds the sum of all amounts payable on the note after the acquisition date, other than payments of qualified stated interest, you will be considered to have purchased the note with amortizable bond premium equal to that excess. The holder may elect to amortize this premium, using a constant-yield method, over the remaining term of the note (where the note is not optionally redeemable prior to its maturity date). If the note may be optionally redeemed prior to maturity, the amount of amortizable bond premium is determined by substituting the call date for the maturity date and the call price for the amount payable at maturity only if the substitution results in a smaller amount of premium attributable to the period before the redemption date.

If you elect to amortize bond premium, you generally may use the amortizable bond premium allocable to an accrual period to offset qualified stated interest otherwise required to be included in income with respect to the note in that accrual period. In addition, you will not be required to include any OID in income with respect to the notes. If you elect to amortize bond premium, you must reduce your tax basis in the note by the amount of the premium amortized in any year. An election to amortize bond premium applies to all taxable debt obligations then owned and thereafter acquired and may be revoked only with the consent of the IRS.

If you make a constant-yield election (as described under "—Original Issue Discount Notes" above) for a note with amortizable bond premium, that election will result in a deemed election to amortize bond premium for all of your debt instruments with amortizable bond premium.

Sale, Exchange or Redemption of the Notes

Upon a sale or exchange of a note (including redemption of a note at maturity), you will recognize taxable gain or loss equal to the difference between the amount realized on the sale, exchange or redemption and your adjusted tax basis in the note. For these purposes, the amount realized does not include any amount attributable to accrued qualified stated interest on the note. Amounts attributable to accrued qualified stated interest are treated as described under "—Payments of Interest" above. Your adjusted tax basis in a note will generally equal the cost of the note, increased by the amounts of any market discount and OID previously included in income with respect to the note and reduced by any amortized premium and any principal payments received and by the amounts of any other payments that do not constitute qualified stated interest.

Except as described below, gain or loss realized on the sale, exchange or redemption of a note will generally be capital gain or loss and will be long-term capital gain or loss if at the time of sale, exchange or redemption the note has been held for more than one year. Exceptions to this general rule apply to the extent of any accrued market discount. See "—Market Discount" above. In addition, other exceptions to this general rule apply in the case of foreign currency notes. See "—Foreign Currency Notes" below. Gain or loss, if any, will generally be U.S.-source income for purposes of computing your foreign tax credit limitation.

Foreign Currency Notes

The following discussion summarizes the principal U.S. federal income tax consequences if you are a U.S. Holder of notes that are denominated in a specified currency other than the U.S. dollar, which we refer to as "foreign currency notes." The tax treatment of foreign currency-linked notes, and notes the payment of interest or principal on which are payable in more than one currency will be specified in the relevant pricing supplement.

The rules applicable to foreign currency notes could require some or all gain or loss on the sale or exchange of a foreign currency note (including redemption of the foreign currency note at maturity) to be recharacterized as ordinary income or loss. The rules applicable to foreign currency notes are complex, and their application may depend on your particular U.S. federal income tax situation. For example, various elections are available under these rules, and whether you should make any of these elections may depend on your particular federal income tax situation. You should consult your tax advisor regarding the U.S. federal income tax consequences of an investment in your foreign currency notes.

If you use the cash method of accounting and receive a payment of qualified stated interest (or proceeds from a sale, exchange or other disposition attributable to accrued qualified stated interest) in a foreign currency with respect to a foreign currency note, you will be required to include in income the U.S. dollar value of the foreign currency payment (determined based on a spot rate on the date the payment is received) regardless of whether the payment is in fact converted to U.S. dollars at the time, and this U.S. dollar value will be your tax basis in the foreign currency. A cash-method holder who receives a payment of qualified stated interest in U.S. dollars pursuant to an option available under that note will be required to include the amount of this payment in income upon receipt.

An accrual-method U.S. Holder will be required to include in income the U.S. dollar value of the amount of interest income (including OID or market discount, but reduced by acquisition premium and amortizable bond premium, to the extent applicable) that has accrued and is otherwise required to be taken into account with respect to a foreign currency note during an accrual period. The U.S. dollar value of the accrued income will be determined by translating the income at the average rate of exchange for the accrual period or, with respect to an accrual period that spans two taxable years, at the average rate for the partial period within the taxable year. You will recognize ordinary income or loss (which will not be treated as interest income or expense) with respect to accrued interest income on the date the interest payment or proceeds from the sale or exchange attributable to accrued interest is actually received. The amount of ordinary income or loss recognized will equal the difference between (i) the U.S. dollar value of the foreign currency payment received (determined on the date the payment is received) in respect of the accrual period (or, where you receive U.S. dollars, the amount of the payment in respect of the accrual period) and (ii) the U.S. dollar value of interest income that has accrued during the accrual period (as determined above). Rules similar to these rules apply in the case of a cash-method taxpayer required to currently accrue OID or market discount.

If you use the accrual-method of accounting, you may elect to translate interest income (including OID) into U.S. dollars at the spot rate on the last day of the interest accrual period (or, in the case of a partial accrual period, the spot rate on the last day of the taxable year) or, if the date of receipt is within five business days of the last day of the interest accrual period, the spot rate on the date of receipt. If you make this election, you must apply it consistently to all debt instruments from year to year and may not change the election without the consent of the IRS.

OID, market discount, acquisition premium and amortizable bond premium on a foreign currency note will be determined in the relevant foreign currency. If you elect to include market discount in income currently, the amount of market discount will be determined for any accrual period in the relevant foreign currency and then translated into U.S. dollars on the basis of the average rate in effect during the accrual period. Foreign currency gain or loss realized with respect to the accrued market discount will be determined in accordance with the rules relating to accrued interest, described above.

If an election to amortize bond premium is made, amortizable bond premium taken into account on a current basis will reduce interest income in units of the relevant foreign currency. Foreign currency gain or loss is realized on amortized bond premium with respect to any period by treating the bond premium amortized in the period in the same manner as on the sale, exchange or retirement of a foreign currency note, as described below, and any foreign currency gain or loss will be ordinary income or loss. If the election is not made, any loss realized on the sale or exchange of a foreign currency note (including redemption at maturity), other than exchange loss, with amortizable bond premium will be a capital loss to the extent of the bond premium.

Your tax basis in a foreign currency note, and the amount of any subsequent adjustment to your tax basis, will be the U.S. dollar value amount of the foreign currency amount paid for that foreign currency note, or of the foreign currency amount of the adjustment, determined on the date of the purchase or adjustment. If you purchase a foreign currency note with previously owned foreign currency you will recognize ordinary income or loss in an amount equal to the difference, if any, between your tax basis in the foreign currency and the U.S. dollar fair market value of the foreign currency note on the date of purchase.

Gain or loss realized upon the sale, exchange or retirement of a foreign currency note that is attributable to fluctuation in currency exchange rates will be ordinary income or loss, which will not be treated as interest income or expense. Gain or loss attributable to fluctuations in exchange rates will equal the difference between (i) the U.S. dollar value of the foreign currency principal amount of the note, determined at the spot rate on the date the payment is received or the note is disposed of, and (ii) the U.S. dollar value of the foreign currency principal amount of the note, determined on the date you acquired the note. Payments received that are attributable to accrued interest will be treated in accordance with the rules applicable to payments of interest on foreign currency notes, described above. The foreign currency gain or loss (with respect to both principal and interest) on a sale, exchange or retirement will be recognized only to the extent of the total gain or loss realized on the sale, exchange or retirement of a foreign currency note.

The source of the foreign currency gain or loss will be determined by reference to your residence or the residence of the "qualified business unit" on the books of which the note is properly reflected. Any gain or loss in excess of foreign currency gain or loss will be capital gain or loss except to the extent of any accrued market discount. If you recognize a loss upon a sale or other disposition of a foreign currency note and that loss is above certain thresholds, you may be required to file a disclosure statement with the IRS. You should consult your tax advisor regarding this reporting obligation.

You will have a tax basis in any foreign currency received on the sale, exchange or retirement of a foreign currency note equal to the U.S. dollar value of the foreign currency, determined at the time of sale, exchange or retirement. A cash-method taxpayer who buys or sells a foreign currency note is required to translate units of foreign currency paid or received into U.S. dollars at the spot rate on the settlement date of the purchase or sale, provided that the notes are traded on an established securities market. An accrual-method taxpayer may elect the same treatment for all purchases and sales of foreign currency obligations, provided that the notes are traded on an established securities market. This election may not be changed without the consent of the IRS. Any gain or loss realized on a sale or other disposition of foreign currency (including its exchange for U.S. dollars or its use to purchase foreign currency notes) will be ordinary income or loss.

Variable Rate Debt Instruments

The following discussion applies only to notes treated as variable rate debt instruments ("VRDIs"), which will be indicated in the relevant pricing supplement. The treatment of VRDIs that are issued at a price that is less than their "stated redemption price at maturity" by more than a *de minimis* threshold (an "OID VRDI Note") will be subject to the OID rules described above under "—Notes with a Term of More than One Year—Original Issue Discount Notes." This includes certain VRDIs that pay interest other than at a single qualified floating rate or at a rate that is (among other things) determined pursuant to a single fixed formula based on objective financial or economic information. If applicable, the relevant pricing supplement will describe the specific tax consequences relating to your OID VRDI Notes. The following discussion applies to VRDIs that are not OID VRDI Notes.

Interest paid on a VRDI generally will be taxable to you as ordinary income at the time it accrues or is received in accordance with your method of tax accounting.

Upon the sale or exchange of a VRDI (including early redemption or redemption at maturity), you will recognize taxable gain or loss in an amount equal to the difference between the amount realized and your adjusted tax basis in the VRDI. In general, gain or loss realized upon the sale or exchange of a VRDI will be capital gain or loss and will be long-term capital gain or loss if you have held the VRDI for more than one year at that time. The deductibility of capital losses is subject to limitations.

For purposes of determining the amount of gain recognized upon the sale or exchange of a VRDI, the amount realized does not include any amount attributable to accrued interest (other than OID), which will be taxed as such. There is no controlling authority, however, regarding the accrual of a contingent interest payment prior to the time it has become fixed. It is therefore unclear what if any portion of the amount realized upon a sale or exchange of a VRDI prior to maturity will be treated as attributable to interest that has not yet become fixed.

If you purchase a VRDI for an amount that is less than its stated redemption price at maturity (or, in the case of an OID VRDI Note, its adjusted issue price), see the discussion above under "—Market Discount." If you purchase a VRDI for an amount that is greater than its adjusted issue price, see the discussion above under "—Acquisition Premium and Amortizable Bond Premium."

Contingent Payment Debt Instruments

Notes properly treated as contingent payment debt instruments ("CPDI Notes") will be subject to the OID provisions of the Code and the Treasury regulations issued thereunder, and you will be required to accrue as interest income the OID on the CPDI Notes as described below. The following discussion does not address the tax treatment of foreign currency denominated CPDI Notes, which will be specified in the relevant pricing supplement.

We are required to determine a "comparable yield" for the CPDI Notes. The comparable yield is the yield at which we could issue a fixed-rate debt instrument with terms similar to those of the CPDI Notes, including the level of subordination, term, timing of payments and general market conditions, but excluding any adjustments for the riskiness of the contingencies or the liquidity of the CPDI Notes. Solely for purposes of determining the amount of interest income that you will be required to accrue, we are also required to construct a "projected payment schedule" in respect of the CPDI Notes representing a payment or a series of payments the amount and timing of which would produce a yield to maturity on the CPDI Notes equal to the comparable yield.

Unless otherwise provided in the relevant pricing supplement, we will provide, and you may obtain, the comparable yield for a particular offering of CPDI Notes, and the related projected payment schedule, by requesting them from Barclays EFS Solutions Structuring Americas, at (212) 528-7198.

Neither the comparable yield nor the projected payment schedule constitutes a representation by us regarding the actual amount(s), if any, that we will pay on the CPDI Notes.

For U.S. federal income tax purposes, you are required to use our determination of the comparable yield and projected payment schedule in determining interest accruals and adjustments in respect of your CPDI Notes, unless you timely disclose and justify the use of other estimates to the IRS. Regardless of your method of tax accounting, you will be required to accrue as interest income OID on your CPDI Notes in each taxable year at the comparable yield, adjusted as described below.

In addition to interest accrued based upon the comparable yield as described above, you will be required to recognize interest income equal to the amount of any net positive adjustment, *i.e.*, the excess of actual payments over projected payments, in respect of a CPDI Note for a taxable year. A net negative adjustment, *i.e.*, the excess of projected payments over actual payments, in respect of a CPDI Note for a taxable year:

- will first reduce the amount of interest in respect of the CPDI Note that you would otherwise be required to include in income in the taxable year; and

- to the extent of any excess, will give rise to an ordinary loss, but only to the extent that the amount of all previous interest inclusions under the CPDI Note exceeds the total amount of your net negative adjustments treated as ordinary loss on the CPDI Note in prior taxable years.

A net negative adjustment is not subject to the limitation imposed on miscellaneous itemized deductions under Code Section 67, and therefore can be deducted against other income such as employment income and interest income. Any net negative adjustment in excess of the amounts described above will be carried forward to offset future interest income in respect of the note or to reduce the amount realized on a sale or exchange of the CPDI Note (including early redemption or redemption at maturity).

Upon a sale or exchange of a CPDI Note (including settlement at maturity, whether in cash or other property), you generally will recognize taxable income or loss equal to the difference between the amount received from the sale, exchange or redemption (or the value of any property received) and your adjusted tax basis in the CPDI Note. Your adjusted tax basis in the CPDI Note will equal the amount you paid to acquire the CPDI Note, increased by the amount of interest income previously accrued by you in respect of the CPDI Note (determined without regard to any of the positive or negative adjustments to interest accruals described above) and decreased by the amount of any prior projected payments in respect of the CPDI Note. You generally must treat any income as interest income and any loss as ordinary loss to the extent of previous interest inclusions (reduced by the total amount of net negative adjustments previously taken into account as ordinary losses), and the balance as capital loss. As with net negative adjustments, these ordinary losses are not subject to the limitation imposed on miscellaneous itemized deductions under Code Section 67. The deductibility of capital losses, however, is subject to limitations. Additionally, if you recognize a loss above certain thresholds, you might be required to file a disclosure statement with the IRS, although this is uncertain. You should consult your tax advisor regarding this reporting obligation.

You will have a tax basis in any property, other than cash, received upon the sale or exchange of a CPDI Note, including in satisfaction of an exchange right or a call right, equal to the fair market value of the property, determined at the time of receipt. Your holding period for the property will commence on the day after its receipt.

Special rules may apply if one or more contingent payments become fixed prior to maturity. For purposes of the preceding sentence, the payment will be treated as fixed if (and when) all remaining contingencies with respect to it are remote or incidental within the meaning of the applicable Treasury regulations. The applicability of these rules, and their potential consequences, will depend upon the specific terms of the relevant offering. Additional details regarding this issue may be provided in the relevant pricing supplement.

If you purchase CPDI Notes for an amount that is different from their "issue price," you will be required to account for this difference, generally by allocating it reasonably among projected payments on the notes or daily portions of interest that you are required to accrue with respect to the notes and treating these allocations as adjustments to your income when the payment is made or the interest accrues. You should consult your tax advisor with respect to the tax consequences of an investment in CPDI Notes, including the treatment of the difference, if any, between your basis in your notes and their adjusted issue price.

Notes Treated as Prepaid Forward or Derivative Contracts

The following describes material U.S. federal income tax consequences of the ownership and disposition of notes that we treat as prepaid forward or derivative contracts for U.S. federal income tax purposes. The relevant pricing supplement will indicate whether we intend to treat the notes as prepaid forward or derivative contracts for U.S. federal income tax purposes. The tax consequences of an investment in these notes are unclear. There is no direct legal authority as to the proper U.S. federal income tax characterization of these notes, and we do not intend to request a ruling from the IRS regarding these notes. The following discussion does not apply to notes that provide for interest or coupon payments. Unless otherwise indicated, the following discussion assumes that the treatment of the notes as prepaid forward or derivative contracts is correct.

Under this treatment, you should not recognize taxable income or loss over the term of the notes prior to their taxable disposition (including at maturity or pursuant to an early redemption or call). Upon a taxable disposition of a note, you should recognize gain or loss equal to the difference between the amount realized on the taxable disposition and your tax basis in the note, which should equal the amount you paid to acquire the note. Subject to the discussion below concerning the potential application of the "constructive ownership" rules under Code Section 1260, this gain or loss should be long-term capital gain or loss if you have held the note for more than one year at that time. The deductibility of capital losses is subject to limitations.

In the case that the notes provide that at maturity you will or may receive the reference asset or other property (that is, if the notes are or may be "physically settleable"), the relevant pricing supplement will describe the specific tax consequences of that feature.

If the notes are linked to an index, the IRS could assert that a "deemed" taxable exchange has occurred on one or more roll dates or index rebalance dates under certain circumstances. If the IRS were successful in asserting that a taxable exchange has occurred, you could be required to recognize gain (but probably not loss), which would equal the amount by which the fair market value of the note exceeds your tax basis therein on the relevant roll date or index rebalance date. Any gain recognized on a deemed exchange should be capital gain. In addition, your holding period for your notes would restart after such deemed taxable exchange.

If the notes are linked to a reference asset that is or includes a "regulated futures contract" within the meaning of Code Section 1256, it is possible that Section 1256 would apply. Generally, under Section 1256, you would be required to mark to market your investment and treat gain or loss as 40% short-term capital gain or loss and 60% long-term capital gain or loss.

Potential Application of the Constructive Ownership Rules

If the reference asset or a basket component is a "pass-thru entity" (such as an exchange-traded fund), the notes could be treated as "constructive ownership transactions" within the meaning of Code Section 1260, in which case the tax consequences of a taxable disposition of the notes could be materially and adversely affected. If a note were treated in whole or in part as a constructive ownership transaction, all or a portion of any long-term capital gain you would otherwise recognize on a taxable disposition of the note (or in the case of physical settlement of the note, are deemed to recognize) would be recharacterized as ordinary income to the extent such gain exceeded the "net underlying long-term capital gain." Under Section 1260, the net underlying long-term capital gain is generally the

net long-term capital gain a taxpayer would have recognized by investing in the underlying pass-thru entity at the inception of the constructive ownership transaction and selling that investment on the date the constructive ownership transaction is closed (*i.e.*, at maturity or earlier disposition). If Section 1260 were to apply to a note, it is unclear how the net underlying long-term capital gain would be computed. It is possible, for instance, where an exchange-traded fund is the sole underlying asset, that the net underlying long-term capital gain could equal the amount of long-term capital gain you would have recognized if on the issue date you had invested the amount you paid to acquire the note in shares of the exchange-traded fund and sold those shares for their fair market value on the date of your taxable disposition of the note. Unless otherwise established by clear and convincing evidence, the net underlying long-term capital gain is treated as zero. Any long-term capital gain recharacterized as ordinary income under Section 1260 would be treated as accruing at a constant rate over the period you held the note, and you would be subject to a notional interest charge in respect of the deemed tax liability on the income treated as accruing in prior tax years. If applicable, the possibility of this treatment will be discussed in the relevant pricing supplement. You should consult your tax advisor regarding the potential application of the constructive ownership rules.

Uncertainties Regarding Tax Treatment as Prepaid Forward or Derivative Contracts

Even if the notes are treated as prepaid forward or derivative contracts, due to the lack of controlling authority, there remain significant additional uncertainties regarding the tax consequences of your ownership and disposition of the notes. For instance, you might be required to include amounts in income during the term of your notes and/or to treat all or a portion of the gain or loss on the taxable disposition of your notes as ordinary income or loss or as short-term capital gain or loss, without regard to how long you held your notes.

In addition, in 2007 the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. The notice focuses in particular on whether to require investors in these instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; the relevance of factors such as the nature of the underlying property to which the instruments are linked; whether these instruments are or should be subject to the "constructive ownership" regime described above; and whether short-term instruments should be subject to any such accrual regime. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the notes, possibly with retroactive effect.

Tax Consequences if Treated as Debt Instruments

If the notes are treated as debt instruments, your tax consequences will be governed by the Treasury regulations relating to the taxation of "contingent payment debt instruments" (described above) if the term of the notes from issue to maturity (including the last possible date that the notes could be outstanding) is more than one year. See "—Notes Treated as Indebtedness for U.S. Federal Income Tax Purposes—Notes with a Term of More than One Year—Contingent Payment Debt Instruments," above.

If the notes are treated as debt instruments and have a term not exceeding one year (including either the issue date or the last possible date that the notes could be outstanding, but not both), they will be treated as short-term obligations. See "—Notes Treated as Indebtedness for U.S. Federal Income Tax Purposes—Notes with a Term of Not More than One Year," above, for the relevant tax consequences in that case.

Notes Treated as Prepaid Income-Bearing Forward or Derivative Contracts

The following describes certain U.S. federal income tax consequences of the ownership and disposition of notes that we treat as prepaid income-bearing forward or derivative contracts for U.S. federal income tax purposes. The relevant pricing supplement will indicate whether we intend to treat a particular offering of notes as prepaid income-bearing forward or derivative contracts for U.S. federal income tax purposes. The tax consequences of an investment in these notes are unclear. There is no direct legal authority as to the proper U.S. federal income tax characterization of these notes, and we do not intend to request a ruling from the IRS regarding these notes. The following discussion does not apply to notes that provide for interest or coupon payments that are contingent. Unless otherwise indicated, the following discussion assumes that the treatment of notes as prepaid income-bearing forward or derivative contracts is correct.

There is no direct controlling authority under current law addressing the proper tax treatment of the coupons or comparable payments on instruments similar to these notes. The coupons may, in whole or in part, be treated as ordinary income to you when received or accrued, in accordance with your method of accounting for U.S. federal income tax purposes. In determining our information reporting responsibilities, if any, we intend to treat the coupons (and any sales proceeds attributable to an accrued but unpaid coupon) as ordinary income. You should consult your tax advisor concerning the treatment of the coupons, including the possibility that they may not be treated as fully includible in income on a current basis. This treatment would affect the amount of your gain or loss upon the taxable disposition of a note, including a cash payment at maturity, or your basis in any reference asset delivered to you at maturity, as applicable.

In the case that the notes provide that at maturity you will or may receive the reference asset or other property (that is, if the notes are or may be "physically settleable"), the relevant pricing supplement will describe the specific tax consequences of that feature.

Upon the taxable disposition of a note (including cash settlement at maturity), you should recognize capital gain or loss equal to the difference between the amount you realize (other than any coupon payment or sales proceeds attributable to an accrued coupon, which we intend to treat as described above) and the amount you paid to acquire the note. This gain or loss should be long-term capital gain or loss if you have held the note for more than one year at that time. The deductibility of capital losses is subject to limitations.

If the notes are linked to an index, the IRS could assert that a "deemed" taxable exchange has occurred on one or more roll dates or index rebalance dates under certain circumstances. If the IRS were successful in asserting that a taxable exchange has occurred, you could be required to recognize gain (but probably not loss), which would equal the amount by which the fair market value of the note exceeds your tax basis therein on the relevant roll date or index rebalance date. Any gain recognized on a deemed exchange should be capital gain. In addition, your holding period for your notes would restart after such deemed taxable exchange.

If the reference asset or a basket component is a "pass-thru entity" (such as an exchange-traded fund), the notes could be treated as "constructive ownership transactions," as discussed above under "—Notes Treated as Prepaid Forward or Derivative Contracts—Potential Application of the Constructive Ownership Rules." If applicable, the possibility of this treatment will be discussed in the relevant pricing supplement.

If the notes are linked to a reference asset that is or includes a "regulated futures contract" within the meaning of Code Section 1256, it is possible that Section 1256 would apply. Generally, under Section 1256, you would be required to mark to market your investment and treat gain or loss as 40% short-term capital gain or loss and 60% long-term capital gain or loss.

Uncertainties Regarding Treatment as a Prepaid Income-Bearing Forward or Derivative Contract

Due to the lack of direct legal authority, even if a note is treated as a prepaid income-bearing forward or derivative contract, there remain substantial uncertainties regarding the tax consequences of owning and disposing of it. For instance, you might be required to include amounts in income during the term of the note in addition to the coupons you receive and/or to treat all or a portion of your gain or loss upon a taxable disposition of the note (in addition to any coupon payment or sales proceeds attributable to an accrued but unpaid coupon, as discussed above) as ordinary income or loss instead of capital gain or loss.

In addition, in 2007 the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. The notice focuses in particular on whether to require investors in these instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; the relevance of factors such as the nature of the underlying property to which the instruments are linked; whether these instruments are or should be subject to the "constructive ownership" regime described above; and whether short-term instruments should be subject to any such accrual regime. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the notes, possibly with retroactive effect.

Tax Consequences if Treated as Debt Instruments

If the notes are treated as debt instruments, your tax consequences will be governed by the Treasury regulations relating to the taxation of "contingent payment debt instruments" (described above) if the term of the notes from issue to maturity (including the last possible date that the notes could be outstanding) is more than one year. See "—Notes Treated as Indebtedness for U.S. Federal Income Tax Purposes—Notes with a Term of More than One Year—Contingent Payment Debt Instruments," above.

If the notes are treated as debt instruments and have a term not exceeding one year (including either the issue date or the last possible date that the notes could be outstanding, but not both), they will be treated as short-term obligations. See "—Notes Treated as Indebtedness for U.S. Federal Income Tax Purposes—Notes with a Term of Not More than One Year," above, for the relevant tax consequences in that case.

Notes Treated as Prepaid Forward or Derivative Contracts with Associated (Contingent) Coupons

The following describes material U.S. federal income tax consequences of the ownership and disposition of notes that we treat as prepaid forward or derivative contracts with associated contingent coupons for U.S. federal income tax purposes. The relevant pricing supplement will indicate whether we intend to treat the notes as prepaid forward or derivative contracts with associated contingent coupons for U.S. federal income tax purposes. The tax consequences of an investment in these notes are unclear. There is no direct legal authority as to the proper U.S. federal income tax treatment of the notes, and we do not intend to request a ruling from the IRS regarding the notes. Unless otherwise indicated, the following discussion assumes that the treatment of the notes as prepaid forward or derivative contracts with associated contingent coupons is correct.

Although the U.S. federal income tax treatment of contingent coupons (including contingent coupons paid in connection with a call, early redemption or at maturity) is uncertain, insofar as we have tax reporting responsibilities with respect to your notes, we expect (in the absence of an administrative determination or judicial ruling to the contrary) to treat any contingent coupons with respect to the notes as ordinary income, unless otherwise indicated in the relevant pricing supplement.

Upon a taxable disposition of a note (including for cash upon an early redemption or at maturity), you should recognize capital gain or loss equal to the difference between the amount realized on the taxable disposition and your tax basis in the note, which should equal the amount you paid to acquire the note (assuming contingent coupons are properly treated as ordinary income, consistent with the position described above). This gain or loss should be long-term capital gain or loss if you have held the note for more than one year at that time. The deductibility of capital losses is subject to limitations. If you sell your note between the time your right to a contingent coupon is fixed and the time it is paid, it is likely that you will be treated as receiving ordinary income equal to the contingent coupon. Although uncertain, it is possible that proceeds received from the taxable disposition of your notes prior to a valuation date but that can be attributed to an expected contingent coupon payment could be treated as ordinary income. You should consult your tax advisor regarding this issue.

In the case that the notes provide that at maturity you will or may receive the reference asset or other property (that is, if the notes are or may be "physically settleable"), the relevant pricing supplement will describe the specific tax consequences of that feature.

If the notes are linked to an index, the IRS could assert that a "deemed" taxable exchange has occurred on one or more roll dates or index rebalance dates under certain circumstances. If the IRS were successful in asserting that a taxable exchange has occurred, you could be required to recognize gain (but probably not loss), which would equal the amount by which the fair market value of the note exceeds your tax basis therein on the relevant roll date or index rebalance date. Any gain recognized on a deemed exchange should be capital gain. In addition, your holding period for your notes would restart after such deemed taxable exchange.

If the notes are linked to a reference asset that is or includes a "regulated futures contract" within the meaning of Code Section 1256, it is possible that Section 1256 would apply. Generally, under Section 1256, you would be required to mark to market your investment and treat gain or loss as 40% short-term capital gain or loss and 60% long-term capital gain or loss.

Uncertainties Regarding Tax Treatment as Prepaid Forward or Derivative Contracts with Associated (Contingent) Coupons

If the notes are treated as prepaid forward or derivative contracts with associated contingent coupons, due to the lack of controlling authority, there remain significant uncertainties regarding the tax consequences of your ownership and disposition of the notes. For instance, you might be required to include amounts in income during the term of your notes in addition to the contingent coupons you receive, and/or to treat all or a portion of the gain or loss on the taxable disposition of your notes (in addition to any amounts attributable to an unpaid contingent coupon, as discussed above) as ordinary income or loss or as short-term capital gain or loss, without regard to how long you held your notes.

In addition, in 2007 the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. The notice focuses in particular on whether to require holders of these instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; the relevance of factors such as the nature of the underlying property to which the instruments are linked; whether these instruments are or should be subject to the "constructive ownership" regime described above; and whether short-term instruments should be subject to any such accrual regime. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially affect the tax consequences of an investment in the notes, possibly with retroactive effect.

Tax Consequences if Treated as Debt Instruments

If the notes are treated as debt instruments, your tax consequences will be governed by the Treasury regulations relating to the taxation of "contingent payment debt instruments" (described above) if the term of the notes from issue to maturity (including the last possible date that the notes could be outstanding) is more than one year. See "—Notes Treated as Indebtedness for U.S. Federal Income Tax Purposes—Notes with a Term of More than One Year—Contingent Payment Debt Instruments," above.

If the notes are treated as debt instruments and have a term not exceeding one year (including either the issue date or the last possible date that the notes could be outstanding, but not both), they will be treated as short-term obligations. See "—Notes Treated as Indebtedness for U.S. Federal Income Tax Purposes—Notes with a Term of Not More than One Year," above, for the relevant tax consequences in that case.

Notes Treated as Put Options and Deposits

The following describes material U.S. federal income tax consequences of the ownership and disposition of notes that we treat as put options and deposits for U.S. federal income tax purposes. The relevant pricing supplement will indicate whether we intend to treat the notes as put options and deposits for U.S. federal income tax purposes. Insofar as we have tax reporting responsibilities with respect to these notes, we expect (in the absence of an administrative determination or judicial ruling to the contrary) to treat them for U.S. federal income tax purposes as units each comprising (i) a put option (a "Put Option") written by you to us with respect to the reference asset and (ii) a deposit of cash equal to the purchase price of the note to secure your potential obligation under the Put Option (the "Deposit"). Under this approach, a portion of each interest payment made with respect to the notes will be treated as interest on the Deposit, and the remainder as premium paid to you in consideration of your entry into the Put Option (a "Put Premium"). We will specify in the relevant pricing supplement the portion of each interest payment that we will allocate to interest on the Deposit and to Put Premium, respectively. The following discussion assumes this treatment is respected, except where otherwise indicated. The relevant pricing supplement may indicate other issues applicable to a particular offering of notes.

Notes with a Term of Not More than One Year

If the term of the notes (including either the issue date or the last possible date that the notes could be outstanding, but not both) is not more than one year and the treatment of the notes as units each comprising a Put Option and a Deposit is respected, the following is a discussion of material U.S. federal income tax consequences of owning and disposing of the notes.

Tax Treatment of Interest Payments. Because the term of the notes is not more than one year, the Deposit will be treated as a short-term obligation for U.S. federal income tax purposes. Under the applicable Treasury regulations, the Deposit will be treated as being issued at a discount equal to the sum of all interest payments to be made with respect to the Deposit. Accordingly, accrual-method holders, and cash-method holders who so elect, will be required to include the discount in income as it accrues on a straight-line basis, unless they elect to accrue the discount on a constant-yield method based on daily compounding. Cash-method holders who do not elect to accrue the discount in income currently will be required to include interest paid on the Deposit upon its receipt. Additionally, cash-method holders who do not elect to accrue the discount in income currently will be required to defer deductions for interest paid on any indebtedness incurred to purchase or carry their notes in amounts not exceeding accrued discount that has not been included in income.

Put Premium will be taken into account as described below.

Taxable Disposition Prior to Maturity or Early Redemption. Upon a taxable disposition of a note prior to maturity or early redemption pursuant to a call, you generally will be required to recognize an amount of short-term capital gain or loss equal to the difference between (i) the proceeds received minus the amount of accrued but unpaid discount on the Deposit and (ii) the purchase price you paid for the note minus the total Put Premium you have received from us. This amount represents the net of the gain or loss attributable to the termination of the Put Option and the gain or loss attributable to the sale of the Deposit. You will recognize interest income with respect to accrued discount on the Deposit that you have not previously included in income. You should consult your tax advisor regarding the separate determination of gain or loss with respect to the Put Option and the Deposit.

Tax Treatment at Maturity or upon Early Redemption. If a note is called or held to maturity and the Put Option expires unexercised (*i.e.*, you receive a cash payment at maturity (not including the final interest payment) equal to the amount of the Deposit), you will recognize short-term capital gain equal to the sum of all Put Premium payments received.

In the case of a note that is by its terms "physically settled" (*i.e*. at maturity you receive the reference asset or other property), you will be deemed to have applied the Deposit toward the physical settlement of the Put Option. You generally will not recognize gain or loss with respect to the Put Premium or the property received. Instead, you generally will have an aggregate basis in the property you receive (including, if applicable, any fractional shares) equal to the Deposit minus the total Put Premium received, and that basis will be allocated proportionately among the property (including any fractional shares, if applicable). Your holding period for the property will begin on the day after receipt. With respect to any cash received in lieu of a fractional share of the property, you will recognize short-term capital gain or loss in an amount equal to the difference between the amount of the cash received and the tax basis allocable to the fractional share.

If, instead, the Put Option is deemed to be exercised at maturity (*i.e.*, you receive a cash payment at maturity (not including the final interest payment) that is less than the amount of your Deposit), you will be deemed to have applied a portion of the Deposit toward the cash settlement of the Put Option. In that case, you will recognize short-term capital gain or loss in an amount equal to the difference between (i) the total Put Premium received and (ii) the cash settlement value of the Put Option (*i.e.*, the Deposit's issue price minus the cash you receive, excluding the final interest payment).

Notes with a Term of More than One Year

If the term of the notes (including either the issue date or the last possible date that the notes could be outstanding, but not both) is more than one year and the treatment of the notes as units each comprising a Put Option and a Deposit is respected, the following is a discussion of material U.S. federal income tax consequences of owning and disposing of the notes. The following discussion assumes that the Deposit is issued without OID. The applicable pricing supplement will discuss the U.S. federal income tax consequences of any Deposit issued with OID.

Tax Treatment of Interest Payments. Interest paid with respect to the Deposit will be taxable to you as ordinary income at the time it accrues or is received, in accordance with your method of accounting for federal income tax purposes.

Put Premium will be taken into account as described below.

Taxable Disposition Prior to Maturity or Early Redemption. Upon a taxable disposition of a note prior to maturity or early redemption pursuant to a call, you should apportion the amount realized between the Deposit and the Put Option based on their respective values on the date of the taxable disposition. The amount of capital gain or loss on the Deposit will equal the amount realized that is attributable to the Deposit (excluding any amount attributable to the accrued but unpaid interest on the Deposit, which will be treated as a payment of interest), minus your tax basis in the Deposit. That gain or loss will be long-term capital gain or loss if the note was held for more than one year.

If the value of the Deposit on the date of the taxable disposition of a note does not exceed the amount realized on the taxable disposition, any amount realized that is attributable to the Put Option, together with the total Put Premium received over the term of the notes, will be treated as short-term capital gain or loss.

If the value of the Deposit on the date of the taxable disposition exceeds the amount realized on the taxable disposition of the note, you will be treated as having (i) sold or exchanged the Deposit for an amount equal to its value on that date and (ii) made a payment to the purchaser of the note equal to the amount of this excess, in exchange for the purchaser's assumption of the Put Option. In this case, you will be required to recognize short-term capital gain or loss in respect of the Put Option equal to the total Put Premium received over the term of the note minus the amount deemed to be paid by you in exchange for the purchaser's assumption of the Put Option.

Tax Treatment at Maturity or upon Early Redemption. If a note is called or held to maturity and the Put Option expires unexercised (*i.e.*, you receive a cash payment at maturity (not including the final interest payment) equal to the amount of the Deposit), you will recognize short-term capital gain equal to the sum of all Put Premium payments received.

In the case of a note that is by its terms physically settled, you will be deemed to have applied the Deposit toward the physical settlement of the Put Option. In that case, you generally will not recognize gain or loss with respect to the Put Premium or the property received. Instead, you generally will have an aggregate basis in the property you receive (including any fractional shares, if applicable) equal to the Deposit minus the Put Premium received, and that basis will be allocated proportionately among the property (including any fractional shares, if applicable). Your holding period for the property will begin on the day after receipt. With respect to any cash received in lieu of a fractional share, you will recognize short-term capital loss in an amount equal to the difference between the amount of the cash received and the tax basis allocable to the fractional share.

If, instead, the Put Option is deemed to be exercised at maturity (*i.e.*, you receive a cash payment at maturity (not including the final interest payment) that is less than the amount of your Deposit), you will be deemed to have applied a portion of the Deposit toward the cash settlement of the Put Option. In that case, you will recognize short-term capital gain or loss in an amount equal to the difference between (i) the total Put Premium received and (ii) the cash settlement value of the Put Option (*i.e.*, the Deposit's issue price minus the cash you receive, excluding the final interest payment).

Other Possible Tax Treatments

Due to the lack of direct legal authority, there are substantial uncertainties regarding the tax consequences of owning and disposing of a note. For instance, you might be required to include the full amount of the interest payments on a note as ordinary income in accordance with your method of accounting. Alternatively, a note might be treated as a single debt instrument for U.S. federal income tax purposes. If so, and if the term of the note exceeds one year, your tax consequences will be governed by Treasury regulations relating to the taxation of contingent payment debt instruments. See "—Notes Treated as Indebtedness for U.S. Federal Income Tax Purposes—Notes with a Term of More than One Year—Contingent Payment Debt Instruments," above. If a note is treated as a single debt instrument and has a term not exceeding one year, it will be treated as a short-term obligation. See "—Notes Treated as Indebtedness for U.S. Federal Income Tax Purposes—Notes with a Term of Not More than One Year," above, for the relevant tax consequences in that case.

In addition, in 2007, the U.S. Treasury Department and the IRS released a notice requesting comments on various issues regarding the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. While it is not clear whether the notes would be viewed as similar to the typical prepaid forward contract described in the notice, it is possible that any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of your investment in a note, possibly with retroactive effect.

Tax Consequences to Non-U.S. Holders

The following discussion applies to you only if you are a "Non-U.S. Holder" of notes. You are a "Non-U.S. Holder" if for U.S. federal income tax purposes you are a beneficial owner of a note that is:

- a nonresident alien individual;
- a foreign corporation; or
- a foreign estate or trust.

You are not a "Non-U.S. Holder" for purposes of this discussion if you are an individual present in the United States for 183 days or more in the taxable year of disposition (including maturity or early redemption) of a note. In this case, you should consult your tax advisor regarding the U.S. federal income tax consequences of the disposition.

Subject to the discussions below under "—Section 871(m) Withholding" and "—Foreign Account Tax Compliance Withholding," we expect to treat payments on your notes, and any gain realized on a disposition of a note (including at maturity or early redemption), as exempt from U.S. federal income tax (including withholding tax), provided that such amounts are not effectively connected with your conduct of a trade or business in the United States. However, you should in any event expect to be required to provide an IRS Form W-8 appropriate to your circumstances or other documentation to establish an exemption from backup withholding, as described below under "—Information Reporting and Backup Withholding."

Notwithstanding the above, if we determine that there is a material risk that we are required to withhold on any payments on the notes, we may withhold on any such payments at a 30% rate unless you submit a properly completed IRS Form W-8 appropriate to your circumstances that reduces or eliminates withholding

In addition, as described above under "—Tax Consequences to U.S. Holders—Notes Treated as Prepaid Forward or Derivative Contracts—Uncertainties Regarding Tax Treatment as Prepaid Forward or Derivative Contracts," in 2007 the U.S. Treasury Department and the IRS released a notice requesting comments on various issues regarding the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. The notice focuses, among other things, on the degree, if any, to which income realized with respect to such instruments by non-U.S. persons should be subject to withholding tax. It is possible that any Treasury regulations or other guidance promulgated after consideration of these issues might require you to accrue income, subject to U.S. federal withholding tax, in each year that you own a note that is treated as a prepaid forward or derivative contract or as a Put Option and Deposit, possibly on a retroactive basis.

We will not pay additional amounts on account of any withholding tax.

Effectively Connected Income

If you are engaged in a trade or business in the United States and if the income or gain on a note is effectively connected with your conduct of that trade or business (and, if an applicable treaty so requires, is attributable to a permanent establishment or fixed base in the United States), although exempt from withholding tax (subject to the discussion below under "—Foreign Account Tax Compliance Withholding,") you will generally be subject to regular U.S. income tax on such income or gain in the same manner as if you were a U.S. Holder. You will not be subject to withholding in this case if you provide a properly completed IRS Form W-8ECI. If this paragraph applies to you, you should consult your tax advisor with respect to other U.S. tax consequences of the ownership and disposition of your notes, including the possible imposition of a 30% branch profits tax if you are a corporation.

Section 871(m) Withholding

Recently promulgated regulations under Code Section 871(m) impose a 30% withholding tax on certain "dividend equivalents" paid or deemed paid with respect to notes linked to U.S. equities or indices that include U.S. equities under certain circumstances, even in cases where the notes do not provide for payments explicitly linked to dividends. In general, this withholding regime applies to notes that substantially replicate the economic performance of one or more underlying U.S. equities, as determined on the notes' issue date, based on one of two tests set forth in the regulations. The regulations provide certain exceptions to the withholding requirements, for example for derivatives linked to certain broad-based indices. This regime will generally apply to notes issued on or after January 1, 2017.

When relevant, we will disclose further information regarding the application of Section 871(m) withholding to any particular issuance of notes in the relevant pricing supplement. Our determination as to whether Section 871(m) withholding applies to the notes is binding on Non-U.S. Holders, but it is not binding on the IRS. The Section 871(m) regulations require complex calculations to be made with respect to notes linked to U.S. equities, and their application to any particular issuance of notes may be uncertain. Accordingly, even if we determine that withholding under Section 871(m) does not apply to the notes, the IRS could challenge our determination and assert that withholding is required in respect of those notes. Additionally, the application of Section 871(m) may be affected by a Non-U.S. Holder's particular circumstances (for example, where a Non-U.S. Holder enters into two or more transactions that reference the same underlying security and the transactions were entered into in connection with each other). We will not pay additional amounts with respect to any withholding taxes under this regime. You should consult your tax advisor regarding the potential application of Section 871(m) to the notes.

Foreign Account Tax Compliance Withholding

Legislation commonly referred to as "FATCA" generally imposes a 30% withholding tax on payments to certain foreign entities (including financial intermediaries) with respect to certain financial instruments, unless various U.S. information reporting and due diligence requirements have been satisfied. This regime applies (i) to any payments on the notes treated as "dividend equivalents" under Code Section 871(m) (as described above under "—Section 871(m) Withholding"); (ii) to any payments on the notes treated as "foreign passthru payments"; and (iii) to the extent that payments on the notes are described in (i) or, potentially, (ii), to the payment on your notes at maturity if your notes mature after December 31, 2018, as well as to the proceeds of any sale or other disposition of a note occurring after December 31, 2018. FATCA withholding will not apply with respect to "dividend equivalents" on notes considered issued before July 1, 2017. In addition, with respect to "foreign passthru payments" on notes, FATCA withholding will not apply to notes considered issued before the date that is six months after the date on which final Treasury regulations defining the term "foreign passthru payments" are issued or, in any case, to payments made before January 1, 2019.

Although unclear as a matter of law, and depending in part on the terms of the particular offering and the circumstances at the time of the particular offering, this regime could require withholding at a 30% rate with respect to coupon payments or payments of amounts treated as interest (including OID) and, after December 31, 2018, with respect to gross proceeds from the sale or redemption (including the redemption at maturity) of the notes. To the extent that we are the withholding agent, we do not currently intend to withhold on the notes under this regime, but if we determine that there is a material risk that such withholding is required, we may withhold on any payment at a 30% rate. If we determine that withholding is so required with respect to payments on an issuance of notes, the applicable pricing supplement will so indicate. We will not pay additional amounts with respect to any such withholding taxes. You should consult your tax advisor regarding the potential application of FATCA to the notes.

Information Reporting and Backup Withholding

You may be subject to information reporting. You may also be subject to backup withholding on payments in respect of your notes unless you provide proof of an applicable exemption or a correct taxpayer identification number and otherwise comply with applicable requirements of the backup withholding rules. If you are a Non-U.S. Holder, you will not be subject to backup withholding if you provide a properly completed IRS Form W-8 appropriate to your circumstances.

Amounts withheld under the backup withholding rules are not additional taxes, and may be refunded or credited against your U.S. federal income tax liability, provided the required information is furnished to the IRS.

THE TAX CONSEQUENCES TO YOU OF OWNING AND DISPOSING OF NOTES MAY BE UNCERTAIN. YOU SHOULD CONSULT YOUR TAX ADVISOR REGARDING THE TAX CONSEQUENCES OF OWNING AND DISPOSING OF NOTES, INCLUDING THE TAX CONSEQUENCES UNDER STATE, LOCAL, FOREIGN AND OTHER TAX LAWS AND THE POSSIBLE EFFECTS OF CHANGES IN U.S. FEDERAL OR OTHER TAX LAWS.

VALIDITY OF SECURITIES

If stated in the pricing supplement applicable to a specific issuance of securities, the validity of the securities under New York law may be passed upon for us by our U.S. counsel, as specified in that pricing supplement. If stated in the pricing supplement applicable to a specific issuance of securities, the validity of the securities under English law may be passed upon by our English solicitors. Our U.S. counsel may rely upon the opinion as to all matters of English law and our English solicitors may rely on the opinion of our U.S. counsel as to all matters of New York law. If this prospectus supplement is delivered in connection with an underwritten offering, the validity of the securities may be passed upon for the underwriters by U.S. and English counsel for the underwriters specified in the related pricing supplement. If no English counsel is specified, such U.S. counsel to the underwriters may also rely on the opinion of our English solicitors as to certain matters of English law.

BARCLAYS BANK PLC

Debt Securities

Warrants

Preference Shares

American Depositary Shares

This prospectus describes some of the general terms that may apply to the securities described herein (the "securities") and the general manner in which they may be offered.

We will give you the specific terms of the securities, and the manner in which they are offered, in supplements to this prospectus. You should read this prospectus and the prospectus supplements carefully before you invest. We may offer and sell these securities to or through one or more underwriters, dealers and agents, including Barclays Capital Inc., or directly to purchasers, on a delayed or continuous basis. We will indicate the names of any underwriters in the applicable prospectus supplement.

We may use this prospectus to offer and sell senior and dated subordinated debt securities, warrants or preference shares from time to time. In addition, Barclays Capital Inc. or another of our affiliates may use this prospectus in market-making transactions in any of these securities after their initial sale. ***Unless we or our agent informs you otherwise in the confirmation of sale, this prospectus is being used in market-making transactions.***

The securities are not deposit liabilities of either Barclays PLC or Barclays Bank PLC and are not covered by the U.K. Financial Services Compensation Scheme or insured by the U.S. Federal Deposit Insurance Corporation or any other governmental agency of the United States, the United Kingdom or any other jurisdiction. Unless otherwise indicated in the applicable prospectus supplement, Barclays PLC, our parent, has not guaranteed or assumed any other obligations in respect of our securities.

This prospectus may not be used to sell securities unless it is accompanied by a prospectus supplement.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

BofA Merrill Lynch

The date of this prospectus is July 18, 2016

TABLE OF CONTENTS

FORWARD-LOOKING STATEMENTS

This prospectus and certain documents incorporated by reference herein contain certain forward-looking statements within the meaning of Section 21E of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Section 27A of the U.S. Securities Act of 1933, as amended (the "Securities Act"), with respect to the Group (as defined below). We caution readers that no forward-looking statement is a guarantee of future performance and that actual results or other financial condition or performance measures could differ materially from those contained in the forward-looking statements. These forward-looking statements can be identified by the fact that they do not relate only to historical or current facts. Forward-looking statements sometimes use words such as "may," "will," "seek," "continue," "aim," "anticipate," "target," "projected," "expect," "estimate," "intend," "plan," "goal," "believe," "achieve" or other words of similar meaning. Examples of forward-looking statements include, among others, statements or guidance regarding our future financial position, income growth, assets, impairment charges, provisions, notable items, business strategy, capital, leverage and other regulatory ratios, payment of dividends (including dividend pay-out ratios and expected payment strategies), projected levels of growth in the banking and financial markets, projected costs or savings, original and revised commitments and targets in connection with the strategic cost programme and the strategy update (the "Group Strategy Update") described in our Current Report on Form 6-K filed with the U.S. Securities and Exchange Commission (the "SEC") on March 1, 2016 (Film No. 161472067) (the "March 1, 2016 6-K"), run-down of assets and businesses within Barclays Non-Core (as such unit is described in our Annual Report on Form 20-F for the fiscal year ended December 31, 2015, filed with the SEC on March 1, 2016 (the "2015 Form 20-F")), sell down of the Group's interest in Barclays Africa Group Limited, estimates of capital expenditures and plans and objectives for future operations, projected employee numbers and other statements that are not historical fact.

By their nature, forward-looking statements involve risk and uncertainty because they relate to future events and circumstances. These may be affected by changes in legislation, the development of standards and interpretations under International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board, evolving practices with regard to the interpretation and application of accounting and regulatory standards, the outcome of current and future legal proceedings and regulatory investigations, future levels of conduct provisions, future levels of notable items, the policies and actions of governmental and regulatory authorities, geopolitical risks and the impact of competition. In addition, factors including (but not limited to) the following may have an effect: capital, leverage and other regulatory rules (including with regard to the future structure of the Group) applicable to past, current and future periods; U.K., United States, Africa, Eurozone and global macroeconomic and business conditions; the effects of continued volatility in credit markets; market-related risks such as changes in interest rates and foreign exchange rates; effects of changes in valuation of credit market exposures; changes in valuation of issued securities; volatility in capital markets; changes in credit ratings of any entities within the Group or any securities issued by such entities; the potential for one or more countries (including the U.K.) exiting the Eurozone; the implications of the results of the June 23, 2016 referendum held in the United Kingdom and the disruption that may result in the U.K. and globally from the proposed withdrawal of the United Kingdom from the European Union; the implementation of the strategic cost programme; and the success of future acquisitions, disposals and other strategic transactions. A number of these influences and factors are beyond our control. As a result, our actual future results, dividend payments and capital and leverage ratios may differ materially from the plans, goals, expectations and guidance set forth in such forward-looking statements. The list above is not exhaustive and there are other factors that may cause our actual results to differ materially from the forward-looking statements contained in this prospectus and the documents incorporated by reference herein. Additional risks and factors are identified in our filings with the SEC including in the 2015 Form 20-F, which is available on the SEC's website at http://www.sec.gov for a discussion of certain factors that should be considered when deciding what action to take in relation to the securities.

Any forward-looking statements made herein or in the documents incorporated by reference herein speak only as of the date they are made and it should not be assumed that they have been revised or updated in the light of new information or future events. Except as required by the Prudential Regulation Authority, the Financial Conduct Authority (the "FCA"), London Stock Exchange plc, the SEC or applicable U.S. or other law, we expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained in this prospectus or the documents incorporated by reference herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement

is based. The reader should, however, consult any additional disclosures that we have made or may make in documents we have filed or may file with the SEC.

INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

The SEC allows us to "incorporate by reference" the information we file with the SEC, which means that we can disclose important information to you by referring you to those documents. The information that we incorporate by reference into this prospectus is an important part of this prospectus. The most recent information that we file with the SEC automatically updates and supersedes earlier information.

We have filed with the SEC a registration statement on Form F-3 relating to the securities covered by this prospectus. This prospectus is a part of the registration statement and omits some of the information contained in the registration statement in accordance with SEC rules and regulations. You should review the information in, and exhibits to, the registration statement for further information on us and the securities we are offering. Statements in this prospectus concerning any document we have filed or will file as an exhibit to the registration statement or that we have otherwise filed with the SEC are not intended to be comprehensive and are qualified in their entirety by reference to these filings. You should review the complete document to evaluate these statements. You may review a copy of the registration statement at the SEC's public reference room in Washington, D.C., as well as through the SEC's internet site, as described under "Where You Can Find More Information" in this prospectus.

We filed the 2015 Form 20-F with the SEC on March 1, 2016. We are incorporating the 2015 Form 20-F, the March 1, 2016 6-K and our Current Reports on Form 6-K filed on April 5, 2016 (Film No. 161554032), April 15, 2016 (Film No. 161573113) and April 27, 2016 (Film No. 161594236) by reference into this prospectus.

In addition, we incorporate by reference into this prospectus any future documents that we may file with the SEC under Section 13(a), 13(c), 14 or 15(d) of the Exchange Act from the date of this prospectus until any offering contemplated in this prospectus is completed. Reports on Form 6-K we may furnish to the SEC after the date of this prospectus (or portions thereof) are incorporated by reference in this prospectus only to the extent that the report expressly states that it is (or such portions are) incorporated by reference in this prospectus.

We will provide to you, upon your written or oral request, without charge, a copy of any or all of the documents referred to above which we have incorporated in this prospectus by reference. You should direct your requests to Barclays Treasury, Barclays PLC, 1 Churchill Place, London E14 5HP, United Kingdom (telephone: 011-44-20-7116-1000).

For purposes of this prospectus, references to "we," "us" and "our" refer to Barclays Bank PLC (or any successor entity) and its consolidated subsidiaries, unless the context indicates otherwise; and references to The Depository Trust Company or "DTC" shall include any successor clearing system. The term "Group" shall mean Barclays PLC and its consolidated subsidiaries, unless the context indicates otherwise. The term "PRA" shall mean the Prudential Regulation Authority of the United Kingdom or such other governmental authority in the United Kingdom (or if Barclays Bank PLC becomes domiciled in a jurisdiction other than the United Kingdom, such other jurisdiction) having primary responsibility for the prudential supervision of Barclays Bank PLC. References to "£" and "sterling" shall be to the lawful currency for the time being of the United Kingdom and references to "$" and "U.S. dollars" shall be to the lawful currency for the time being of the United States.

THE BARCLAYS BANK GROUP

Barclays Bank PLC (the "Issuer") and its subsidiary undertakings (taken together, the "Barclays Bank Group") is a transatlantic consumer, corporate and investment bank offering products and services across personal, corporate and investment banking, credit cards and wealth and management, with a strong presence in our two home markets of the United Kingdom and the United States. Following the Group Strategy Update, the Barclays Bank Group will be focused on two core divisions – Barclays UK and Barclays Corporate & International. Barclays UK comprises the U.K. retail banking operations, U.K. consumer credit card business, U.K. wealth management business and corporate banking for smaller businesses. Barclays Corporate & International comprises the corporate banking franchise, the Investment Bank, the U.S. and international cards business and international wealth management.

Assets which do not fit the Barclays Bank Group's strategic objective will continue to be managed in Barclays Non-Core and designated for exit or run-down over time. The whole of the issued ordinary share capital of Barclays Bank PLC is beneficially owned by Barclays PLC, which is the ultimate holding company of the Barclays Bank Group.

USE OF PROCEEDS

Unless otherwise indicated in the accompanying prospectus supplement, the net proceeds from the offering of the securities will be used to support the development and expansion of our business and to strengthen further our capital base. That development and expansion may occur through the development of existing operations, the establishment of new subsidiaries or acquisitions if suitable opportunities should arise.

DESCRIPTION OF DEBT SECURITIES

The following is a summary of the general terms of the debt securities. It sets forth possible terms and provisions for each series of debt securities. Each time that we offer debt securities, we will prepare and file a prospectus supplement with the SEC, which you should read carefully. The prospectus supplement may contain additional terms and provisions of those securities. If there is any inconsistency between the terms and provisions presented here and those in the prospectus supplement, those in the prospectus supplement will apply and will replace those presented here.

The debt securities of any series will be either our senior obligations (the "Senior Debt Securities") or our dated subordinated obligations (the "Dated Subordinated Debt Securities" and together with the Senior Debt Securities, the "debt securities"). Neither the Senior Debt Securities nor the Dated Subordinated Debt Securities will be secured by any assets or property of Barclays Bank PLC or any of its subsidiaries or affiliates (including Barclays PLC, its parent).

We will issue Senior Debt Securities and Dated Subordinated Debt Securities under indentures (respectively, the "Senior Debt Indenture" and "Dated Subordinated Debt Indenture") between us and The Bank of New York Mellon, as trustee. The terms of the debt securities include those stated in the relevant indenture and any supplements thereto, and those terms made part of the indenture by reference to the U.S. Trust Indenture Act of 1939, as amended (the "Trust Indenture Act"). The Senior Debt Indenture and Dated Subordinated Debt Indenture are sometimes referred to in this prospectus individually as an "indenture" and collectively as the "indentures." We have filed or incorporated by reference a copy of, or the forms of, each indenture as exhibits to the registration statement, of which this prospectus is a part.

Because this section is a summary, it does not describe every aspect of the debt securities in detail. This summary is subject to, and qualified by reference to, all of the definitions and provisions of the relevant indenture, any supplement to the relevant indenture and each series of debt securities. Certain terms, unless otherwise defined here, have the meaning given to them in the relevant indenture.

General

The debt securities are not deposit liabilities of either Barclays PLC or Barclays Bank PLC and are not covered by the U.K. Financial Services Compensation Scheme or insured by the U.S. Federal Deposit Insurance Corporation or any other governmental agency of the United States, the United Kingdom or any other jurisdiction. Unless otherwise indicated in a prospectus supplement, Barclays PLC, our parent, has not guaranteed or assumed any obligations in respect of our debt securities.

Because we are a holding company as well as an operating company, our rights to participate in the assets of any of our subsidiaries upon its liquidation will be subject to the prior claims of the subsidiaries' creditors, including, in the case of our bank subsidiaries, their respective depositors, except, in our case, to the extent that we may ourselves be a creditor with recognized claims against the relevant subsidiary.

The indentures do not limit the amount of debt securities that we may issue. We may issue the debt securities in one or more series, or as units comprised of two or more related series. The prospectus supplement will indicate for each series or of two or more related series of debt securities:

- the issue date;
- the maturity date;
- the specific designation and aggregate principal amount of the debt securities;
- any limit on the aggregate principal amount of the debt securities that may be authenticated or delivered;

- under what conditions, if any, another issuer may be substituted for Barclays Bank PLC as the issuer of the debt securities of the series;
- the prices at which we will issue the debt securities;
- if interest is payable, the interest rate or rates, or how to calculate the interest rate or rates, and under what circumstances interest is payable;
- whether we will issue the Senior Debt Securities or Dated Subordinated Debt Securities as Discount Securities, as explained in this section below, and the amount of the discount;
- provisions, if any, for the discharge and defeasance of Senior Debt Securities or Dated Subordinated Debt Securities of any series;
- any condition applicable to payment of any principal, premium or interest on Senior Debt Securities or Dated Subordinated Debt Securities of any series;
- the dates and places at which any payments are payable;
- the places where notices, demands to or upon us in respect of the debt securities may be served and notice to holders may be published;
- the terms of any mandatory or optional redemption;
- the denominations in which the debt securities will be issued, which may be an integral multiple of either $1,000, $25 or any other specified amount;
- the amount, or how to calculate the amount, that we will pay to the Senior Debt Security holder or Dated Subordinated Debt Security holder, if the Senior Debt Security or Dated Subordinated Debt Security is redeemed before its stated maturity or accelerated, or for which the trustee shall be entitled to file and prove a claim;
- whether and how the debt securities may or must be converted into any other type of securities, or their cash value, or a combination of these;
- the currency or currencies in which the debt securities are denominated, and in which we make any payments;
- whether we will issue the debt securities wholly or partially as one or more global debt securities;
- what conditions must be satisfied before we will issue the debt securities in definitive form ("definitive debt securities");
- any reference asset we will use to determine the amount of any payments on the debt securities;
- any other or different Senior Events of Default, in the case of Senior Debt Securities, or any other or different Dated Subordinated Events of Default, in the case of Dated Subordinated Debt Securities, or covenants applicable to any of the debt securities, and the relevant terms if they are different from the terms in the applicable indenture;
- in the case of Dated Subordinated Debt Securities, the applicable subordination provisions;
- any restrictions applicable to the offer, sale and delivery of the debt securities;

- whether we will pay Additional Amounts, as defined below, on the debt securities;
- whether we will issue the debt securities in registered form ("registered securities") or in bearer form ("bearer securities") or both;
- for registered securities, the record date for any payment of principal, interest or premium;
- any listing of the debt securities on a securities exchange;
- the names and duties of any co-trustees, depositaries, authenticating agents, paying agents, calculation agents, transfer agents or registrars of any series;
- any applicable additional provisions or provisions related to the U.K. Bail-in Power (as defined below) in connection with applicable regulatory capital or other requirements;
- any other or different terms of the debt securities; and
- what we believe are any additional material U.S. federal and U.K. tax considerations.

If we issue debt securities in bearer form, the special restrictions and considerations relating to such bearer debt securities, including applicable offering restrictions and U.S. tax considerations, will be described in the relevant prospectus supplement.

Debt securities may bear interest at a fixed rate or a floating rate or we may sell Senior Debt Securities or Dated Subordinated Debt Securities that bear no interest or that bear interest at a rate below the prevailing market interest rate or at a discount to their stated principal amount ("Discount Securities"). The relevant prospectus supplement will describe special U.S. federal income tax considerations applicable to Discount Securities or to debt securities issued at par that are treated for U.S. federal income tax purposes as having been issued at a discount.

Holders of debt securities have no voting rights except as explained in this section below under "—Modification and Waiver" and "Senior Events of Default; Dated Subordinated Enforcement Events and Remedies; Limitation on Suits."

References to "you" and "holder" in the sections "—Agreement with Respect to the Exercise of U.K. Bail-in Power," "—Additional Amounts" and "—Dated Subordinated Enforcement Events and Remedies" below, include beneficial owners of the debt securities.

Market-Making Transactions. If you purchase your debt security and/or any of our other securities we describe in this prospectus in a market-making transaction, you will receive information about the price you pay and your trade and settlement dates in a separate confirmation of sale. A market-making transaction is one in which Barclays Capital Inc. or another of our affiliates resells a security that it has previously acquired from another holder. A market-making transaction in a particular debt security occurs after the original issuance and sale of the debt security.

Agreement with Respect to the Exercise of U.K. Bail-in Power

Notwithstanding any other agreements, arrangements or understandings between us and any holder of the debt securities, by acquiring the debt securities, each holder of the debt securities acknowledges, accepts, agrees to be bound by, and consents to the exercise of, any U.K. Bail-in Power (as defined below) by the relevant U.K. resolution authority (as defined below) that may result in (i) the reduction or cancellation of all, or a portion, of the principal amount of, interest on, or any other amounts payable on, the debt securities; (ii) the conversion of all, or a portion, of the principal amount of, interest on, or any other amounts payable on, the debt securities into shares or other securities or other obligations of the Issuer or another person (and the issue to, or conferral on, the holder of the debt securities such shares, securities or obligations); and/or (iii) the amendment or alteration of the maturity of the debt securities, or amendment of the amount of interest or any other amounts due on the debt securities, or the dates on

which interest or any other amounts become payable, including by suspending payment for a temporary period; which U.K. Bail-in Power may be exercised by means of a variation of the terms of the debt securities solely to give effect to the exercise by the relevant U.K. resolution authority of such U.K. Bail-in Power. Each holder of the debt securities further acknowledges and agrees that the rights of the holders of the debt securities are subject to, and will be varied, if necessary, solely to give effect to, the exercise of any U.K. Bail-in Power by the relevant U.K. resolution authority. For the avoidance of doubt, this consent and acknowledgment is not a waiver of any rights holders of the debt securities may have at law if and to the extent that any U.K. Bail-in Power is exercised by the relevant U.K. resolution authority in breach of laws applicable in England.

For purposes of the debt securities, a "U.K. Bail-in Power" is any write-down, conversion, transfer, modification and/or suspension power existing from time to time under any laws, regulations, rules or requirements relating to the resolution of banks, banking group companies, credit institutions and/or investment firms incorporated in the United Kingdom in effect and applicable in the United Kingdom to the Issuer or other members of the Group (as defined herein), including but not limited to any such laws, regulations, rules or requirements that are implemented, adopted or enacted within the context of any applicable European Union directive or regulation of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms, and/or within the context of a U.K. resolution regime under the U.K. Banking Act 2009, as the same has been or may be amended from time to time (whether pursuant to the U.K. Financial Services (Banking Reform) Act 2013 (the "Banking Reform Act 2013"), secondary legislation or otherwise, the "Banking Act"), pursuant to which obligations of a bank, banking group company, credit institution or investment firm or any of its affiliates can be reduced, cancelled, amended, transferred and/or converted into shares or other securities or obligations of the obligor or any other person (and a reference to the "relevant U.K. resolution authority" is to any authority with the ability to exercise a U.K. Bail-in Power).

No repayment of the principal amount of the debt securities or payment of interest or any other amounts payable on the debt securities shall become due and payable after the exercise of any U.K. Bail-in Power by the relevant U.K. resolution authority unless such repayment or payment would be permitted to be made by the Issuer under the laws and regulations of the United Kingdom and the European Union applicable to the Issuer.

By its acquisition of the debt securities, each holder of the debt securities, to the extent permitted by the Trust Indenture Act, waives any and all claims against the trustee for, agrees not to initiate a suit against the trustee in respect of, and agrees that the trustee shall not be liable for, any action that the trustee takes, or abstains from taking, in either case in accordance with the exercise of the U.K. Bail-in Power by the relevant U.K. resolution authority with respect to the debt securities.

Upon the exercise of the U.K. Bail-in Power by the relevant U.K. resolution authority with respect to the debt securities, the Issuer shall provide a written notice to DTC as soon as practicable regarding such exercise of the U.K. Bail-in Power for purposes of notifying holders of such occurrence. The Issuer shall also deliver a copy of such notice to the trustee for information purposes.

By its acquisition of the debt securities, each holder of the debt securities acknowledges and agrees that the exercise of the U.K. Bail-in Power by the relevant U.K. resolution authority with respect to the debt securities shall not give rise to a default for purposes of Section 315(b) (Notice of Default) and Section 315(c) (Duties of the Trustee in Case of Default) of the Trust Indenture Act.

The Issuer's obligations to indemnify the trustee in accordance with the indentures shall survive the exercise of the U.K. Bail-in Power by the relevant U.K. resolution authority with respect to any debt securities.

By its acquisition of the debt securities, each holder of the debt securities acknowledges and agrees that, upon the exercise of any U.K. Bail-in Power by the relevant U.K. resolution authority with respect to the debt securities, (a) the trustee shall not be required to take any further directions from holders of the debt securities under Section 5.12 (Control by Holders) of the Senior Debt Indenture or Section 5.13 (Control by Holders) of the Dated Subordinated Debt Indenture, as applicable, which sections authorize holders of a majority in aggregate outstanding principal amount of the debt securities to direct certain actions relating to the debt securities, and (b) the indentures shall impose no duties upon the trustee whatsoever with respect to the exercise of any U.K. Bail-in Power by the relevant

U.K. resolution authority. Notwithstanding the foregoing, if, following the completion of the exercise of the U.K. Bail-in Power by the relevant U.K. resolution authority in respect of the debt securities, the debt securities remain outstanding (for example, if the exercise of the U.K. Bail-in Power results in only a partial write-down of the principal of such debt securities), then the trustee's duties under the indentures shall remain applicable with respect to the debt securities following such completion to the extent that the Issuer and the trustee shall agree pursuant to a supplemental indenture or an amendment thereto.

By its acquisition of the debt securities, each holder of the debt securities shall be deemed to have (a) consented to the exercise of any U.K. Bail-in Power as it may be imposed without any prior notice by the relevant U.K. resolution authority of its decision to exercise such power with respect to the debt securities and (b) authorized, directed and requested DTC and any direct participant in DTC or other intermediary through which it holds the debt securities to take any and all necessary action, if required, to implement the exercise of any U.K. Bail-in Power with respect to the debt securities as it may be imposed, without any further action or direction on the part of such holder or the trustee.

Under the terms of the Senior Debt Securities, the exercise of the U.K. Bail-in Power by the relevant U.K. resolution authority with respect to the Senior Debt Securities will not be a default or an Event of Default (as each term is defined in the Senior Debt Indenture).

Under the terms of the Dated Subordinated Debt Securities, the exercise of the U.K. Bail-in Power by the relevant U.K. resolution authority with respect to the Dated Subordinated Debt Securities is not a Winding-up Event or a default in payment.

If any debt securities provide for the delivery of property, any reference in this prospectus and the relevant prospectus supplement or pricing supplement to payment by Barclays Bank PLC under the debt securities will be deemed to include that delivery of property.

Subsequent Holders' Agreement. Holders of debt securities that acquire such debt securities in the secondary market shall be deemed to acknowledge, agree to be bound by and consent to the same provisions described herein and in the relevant prospectus supplement to the same extent as the holders of such debt securities that acquire the debt securities upon their initial issuance, including, without limitation, with respect to the acknowledgement and agreement to be bound by and consent to the terms of the debt securities, including in relation to the U.K. Bail-in Power and, with respect to the Dated Subordinated Debt Securities, the limitations on remedies specified in "—Dated Subordinated Enforcement Events and Remedies —Limited remedies for breach of obligations (other than non-payment)" below.

Legal Ownership; Form of Debt Securities

Street Name and Other Indirect Holders. Investors who hold debt securities in accounts at banks or brokers will generally not be recognized by us as legal holders of debt securities. This is called holding in "street name."

Instead, we would recognize only the bank or broker, or the financial institution the bank or broker uses to hold its debt securities. These intermediary banks, brokers and other financial institutions pass along principal, interest and other payments on the debt securities, either because they agree to do so in their customer agreements or because they are legally required to do so. An investor who holds debt securities in street name should check with the investor's own intermediary institution to find out:

- how it handles debt securities payments and notices;
- whether it imposes fees or charges;
- how it would handle voting if it were ever required;
- whether and how the investor can instruct it to send the investor's debt securities registered in the investor's own name so the investor can be a direct holder as described below; and

- how it would pursue rights under the debt securities if there were a default or other event triggering the need for holders to act to protect their interests.

Direct Holders. Our obligations, as well as the obligations of the trustee and those of any third parties employed by us or the trustee, run only to persons who are registered as holders of debt securities. As noted above, we do not have obligations to an investor who holds in street name or other indirect means, either because the investor chooses to hold debt securities in that manner or because the debt securities are issued in the form of global securities as described below. For example, once we make payment to the registered holder, we have no further responsibility for the payment even if that holder is legally required to pass the payment along to the investor as a street name customer but does not do so.

Global Securities. A global security is a special type of indirectly held security, as described above under "—Legal Ownership; Form of Debt Securities—Street Name and Other Indirect Holders." If we issue debt securities in the form of global securities, the ultimate beneficial owners can only be indirect holders.

We require that the global security be registered in the name of a financial institution we select. In addition, we require that the debt securities included in the global security not be transferred to the name of any other direct holder unless the special circumstances described in the section "Global Securities" occur. The financial institution that acts as the sole direct holder of the global security is called the depositary. Any person wishing to own a security must do so indirectly by virtue of an account with a broker, bank or other financial institution that in turn has an account with the depositary. Unless the applicable prospectus supplement indicates otherwise, each series of debt securities will be issued only in the form of global securities.

Further details of legal ownership are discussed in the section "Global Securities" in this prospectus.

In the remainder of this section, "holders" means direct holders and not street name or other indirect holders of debt securities. Indirect holders should read the subsection entitled "—Legal Ownership; Form of Debt Securities—Street Name and Other Indirect Holders."

Payment and Paying Agents. We will pay interest to direct holders listed in the trustee's records at the close of business on a particular day in advance of each due date for interest, even if the direct holder no longer owns the security on the interest due date. That particular day, usually about one business day in advance of the interest due date, is called the regular record date and is stated in the applicable prospectus supplement.

We will pay interest, principal and any other money due on the debt securities at the corporate trust office of the trustee in New York City. Holders of debt securities must make arrangements to have their payments picked up at or wired from that office. We may also choose to pay interest by mailing checks.

Street name and other indirect holders should consult their banks or brokers for information on how they will receive payments.

We may also arrange for additional payment offices, and may cancel or change these offices, including our use of the trustee's corporate trust office. These offices are called paying agents. We may also choose to act as our own paying agent. We must notify the trustee of changes in the paying agents for any particular series of debt securities.

Payments

The relevant prospectus supplement will specify the date on which we will pay interest, if any, and the date for payments of principal and any premium on any particular series of debt securities. The prospectus supplement will also specify the interest rate or rates, if any, or how the rate or rates will be calculated.

Ranking

Senior Debt Securities. Senior Debt Securities and the coupons (if any) appertaining thereto constitute our direct, unconditional, unsecured and unsubordinated obligations ranking *pari passu*, without any preference among

themselves, with all our other outstanding unsecured and unsubordinated obligations, present and future, except such obligations as are preferred by operation of law.

Dated Subordinated Debt Securities. Dated Subordinated Debt Securities and the coupons (if any) appertaining thereto constitute our direct, unsecured and subordinated obligations ranking *pari passu* without any preference among themselves. The relevant prospectus supplement will set forth the nature of the subordination provisions, including subordinated ranking of each series of Dated Subordinated Debt Securities relative to the debt and equity issued by us, including the extent to which the Dated Subordinated Debt Securities may rank junior in right of payment to our other obligations or in any other manner.

Additional Amounts

Unless the relevant prospectus supplement provides otherwise, we will pay any amounts to be paid by us on any series of debt securities without deduction or withholding for, or on account of, any and all present or future income, stamp and other taxes, levies, imposts, duties, charges, fees, deductions or withholdings ("taxes") now or hereafter imposed, levied, collected, withheld or assessed by or on behalf of the United Kingdom or any political subdivision or authority thereof or therein that has the power to tax (each, a "taxing jurisdiction"), unless the deduction or withholding is required by law. Unless the relevant prospectus supplement provides otherwise, at any time a taxing jurisdiction requires us to deduct or withhold taxes, we will pay the additional amounts of, or in respect of, the principal of, any premium, and any interest on the debt securities ("Additional Amounts") that are necessary so that the net amounts paid to the holders, after the deduction or withholding, shall equal the amounts which would have been payable had no such deduction or withholding been required. However, we will not pay Additional Amounts for taxes that are payable because:

- the holder or the beneficial owner of the debt securities is a domiciliary, national or resident of, or engages in business or maintains a permanent establishment or is physically present in, a taxing jurisdiction requiring that deduction or withholding, or otherwise has some connection with the taxing jurisdiction other than the holding or ownership of the debt security, or the collection of any payment of, or in respect of, the principal of, any premium, or any interest on, any debt securities of the relevant series;

- except in the case of our winding-up in England, the relevant debt security is presented for payment in the United Kingdom;

- the relevant debt security is presented for payment more than 30 days after the date payment became due or was provided for, whichever is later, except to the extent that the holder would have been entitled to the Additional Amounts on presenting the debt security for payment at the close of such 30-day period;

- the holder or the beneficial owner of the relevant debt securities or the beneficial owner of any payment of (or in respect of) principal of, premium, if any, or any interest on debt securities failed to make any necessary claim or to comply with any certification, identification or other requirements concerning the nationality, residence, identity or connection with the taxing jurisdiction of such holder or beneficial owner, if such claim or compliance is required by statute, treaty, regulation or administrative practice of the taxing jurisdiction as a condition to relief or exemption from such taxes;

- the relevant debt security is presented for payment by or on behalf of a holder who would have been able to avoid such deduction or withholding by presenting the relevant debt security to another paying agent in a member state of the European Union or elsewhere; or

- if the taxes would not have been imposed or would have been excluded under one of the preceding points if the beneficial owner of, or person ultimately entitled to obtain an interest in, the debt securities had been the holder of the debt securities.

Whenever we refer in this prospectus and any prospectus supplement to the payment of the principal of, any premium, or any interest on, or in respect of, any debt securities of any series, we mean to include the payment of Additional Amounts to the extent that, in context, Additional Amounts are, were or would be payable.

The government of any jurisdiction where Barclays Bank PLC is incorporated may require Barclays Bank PLC to withhold amounts from payments on the principal or interest on the debt securities, as the case may be, for taxes or any other governmental charges. If a withholding of this type is required, Barclays Bank PLC may be required to pay you an additional amount so that the net amount you receive will be the amount specified in the note to which you are entitled.

For the avoidance of doubt, unless the relevant prospectus supplement provides otherwise, any amounts to be paid by us or any paying agent on the debt securities will be paid net of any deduction or withholding imposed or required pursuant to Sections 1471 through 1474 of the U.S. Internal Revenue Code of 1986, as amended (the "Code"), any current or future regulations or official interpretations thereof, any agreement entered into pursuant to Section 1471(b) of the Code, or any fiscal or regulatory legislation, rules or practices adopted pursuant to any intergovernmental agreement entered into in connection with the implementation of such Sections of the Code (or any law implementing such an intergovernmental agreement) (a "FATCA Withholding Tax"), and we and any paying agent will not be required to pay Additional Amounts on account of any FATCA Withholding Tax.

With respect to Dated Subordinated Debt Securities, any paying agent shall be entitled to make a deduction or withholding from any payment which it makes under the Dated Subordinated Debt Securities and the Dated Subordinated Debt Indenture for or on account of (i) any present or future taxes, duties or charges if and to the extent so required by any applicable law and (ii) any FATCA Withholding Tax (together, "Applicable Law"). In either case, the paying agent shall make any payment after a deduction or withholding has been made pursuant to Applicable Law and shall report to the relevant authorities the amount so deducted or withheld. In all cases, the paying agent shall have no obligation to gross up any payment made subject to any deduction or withholding pursuant to Applicable Law. In addition, amounts deducted or withheld by the Paying Agent under this paragraph will be treated as paid to the holder of a Dated Subordinated Debt Security, and we will not pay Additional Amounts in respect of such deduction or withholding, except to the extent the provisions in this subsection "—Additional Amounts" explicitly provide otherwise.

Redemption

Redemption of Senior Debt Securities for Tax Reasons. Subject to the provisions set out in "—Notice of Redemption" below and unless the relevant prospectus supplement provides otherwise, we will have the option to redeem the Senior Debt Securities of any series if:

- we are required to issue definitive debt securities (see "Global Securities—Special Situations When a Global Security Will Be Terminated") and, as a result, we are or would be required to pay Additional Amounts with respect to the Senior Debt Securities; or

- we determine that as a result of a change in or amendment to the laws or regulations of a taxing jurisdiction, including any treaty to which the relevant taxing jurisdiction is a party, or a change in an official application of those laws or regulations on or after the issue date of the Senior Debt Securities, including a decision of any court or tribunal, which becomes effective on or after the issue date of the Senior Debt Securities (and, in the case of a successor entity, which becomes effective on or after the date of that entity's assumption of our obligations), we (or any successor entity):

  (i) will or would be required to pay holders Additional Amounts with respect to the Senior Debt Securities;

  (ii) would not be entitled to claim a deduction in respect of any payment in respect of the Senior Debt Securities in computing our (or its) taxation liabilities (or the value of any such deduction would be materially reduced); or

  (iii) we would not, as a result of the Senior Debt Securities being in issue, be able to have losses or deductions set against the profits or gains, or profits or gains offset by the losses or deductions, of companies with which we are or would otherwise be so grouped for applicable United Kingdom tax purposes (whether under the group relief system current

as at the date of this prospectus or any similar system or systems having like effect as may from time to time exist),

provided that in each case, the consequences cannot be avoided by us taking reasonable measures available to us.

In each case and unless the relevant prospectus supplement provides otherwise, before we give a notice of redemption (which notice shall be irrevocable), we shall be required to deliver to the trustee a written legal opinion of independent counsel of recognized standing, chosen by us, in a form satisfactory to the trustee, confirming that we are entitled to exercise our right of redemption. The redemption must be made in respect of all, but not some, of the Senior Debt Securities of the relevant series. The redemption price will be equal to 100% of the principal amount of debt securities being redeemed together with any accrued but unpaid interest, in respect of such Senior Debt Securities to the date fixed for redemption or, in the case of Senior Debt Securities which are Discount Securities, such portion of the principal amount of such Discount Securities as may be specified by their terms.

Redemption of Dated Subordinated Debt Securities for Tax Reasons. Subject to the provisions set out in "—Condition to Redemption of Dated Subordinated Debt Securities" and "—Notice of Redemption" below, and unless the relevant prospectus supplement provides otherwise, we will have the option to redeem the Dated Subordinated Debt Securities of any series if we determine that as a result of a change in, or amendment to, the laws or regulations of a taxing jurisdiction, including any treaty to which the relevant taxing jurisdiction is a party, or a change in an official application of those laws or regulations on or after the issue date of the Dated Subordinated Debt Securities, including a decision of any court or tribunal which becomes effective on or after the issue date of the relevant Dated Subordinated Debt Securities (and, in the case of a successor entity, which becomes effective on or after the date of that entity's assumption of our obligations):

- we will or would be required to pay Additional Amounts with respect to the Dated Subordinated Debt Securities;

- we would not be entitled to claim a deduction in respect of any payment in respect of the Dated Subordinated Debt Securities in computing our taxation liabilities (or the value of any such deduction would be reduced); or

- we would not, as a result of the Dated Subordinated Debt Securities being in issue, be able to have losses or deductions set against the profits or gains, or profits or gains offset by the losses or deductions, of companies with which we are or would otherwise be so grouped for applicable United Kingdom tax purposes (whether under the group relief system current as at the date of this prospectus or any similar system or systems having like effect as may from time to time exist).

(each such change in tax law or regulation or the official application thereof, a "Tax Event"),

provided that in the case of each Tax Event, the consequences of the Tax Event cannot be avoided by us taking reasonable measures available to us.

In each case, and unless the relevant prospectus supplement provides otherwise, before we give a notice of redemption, we shall be required to deliver to the trustee a written legal opinion of independent counsel of recognized standing, chosen by us, in a form satisfactory to the trustee, confirming that we are entitled to exercise our right of redemption. The redemption must be made in respect of all, but not some, of the Dated Subordinated Debt Securities of the relevant series. The redemption price will be equal to 100% of the principal amount of Dated Subordinated Debt Securities being redeemed, together with any accrued but unpaid interest in respect of such Dated Subordinated Debt Securities to (but excluding) the date fixed for redemption or, in the case of Dated Subordinated Debt Securities which are Discount Securities, such portion of the principal amount of such Discount Securities as may be specified by their terms.

Optional Redemption. The relevant prospectus supplement will specify whether we may redeem the debt securities of any series, in whole or in part, at our option, in any other circumstances. The prospectus supplement will also

specify the notice we will be required to give, what prices and any premium we will pay, and the dates on which we may redeem the debt securities. Any notice of redemption of debt securities will state:

- the date fixed for redemption;
- the amount of debt securities to be redeemed if we are only redeeming a part of the series;
- the redemption price;
- that on the date fixed for redemption the redemption price will become due and payable on each debt security to be redeemed and, if applicable, that any interest will cease to accrue on or after the redemption date;
- the place or places at which each holder may obtain payment of the redemption price; and
- the CUSIP number or numbers, if any, with respect to the debt securities.

In the case of a partial redemption, the trustee shall select the debt securities that we will redeem in any manner it deems fair and appropriate.

Condition to Redemption of Dated Subordinated Debt Securities. Notwithstanding any other provision, and unless otherwise specified in the applicable prospectus supplement, we may redeem Dated Subordinated Debt Securities (and give notice thereof to the holders of such Dated Subordinated Debt Securities) only if we have obtained the PRA's prior consent (if such consent is then required by Capital Regulations) for the redemption of the relevant Dated Subordinated Debt Securities.

The rules under CRD IV currently provide that the competent authority (the PRA in our case) shall grant permission to a redemption or repurchase provided that any of the following conditions is met, as applicable to the Dated Subordinated Debt Securities:

(1) on or before the redemption or repurchase of the Dated Subordinated Debt Securities, we replace the Dated Subordinated Debt Securities with instruments qualifying as own funds instruments of an equal or higher quality on terms that are sustainable for our income capacity;

(2) we have demonstrated to the satisfaction of the PRA that our own funds would, following such redemption, exceed the capital ratios required under CRD IV by a margin that the PRA may consider necessary on the basis set out in CRD IV for it to determine the appropriate level of capital of an institution.

In addition, the rules under CRD IV provide that the PRA may only permit us to redeem the Dated Subordinated Debt Securities before five years after the date of issuance of the relevant Dated Subordinated Debt Securities if the conditions listed in paragraphs (1) or (2) above are met and either:

(1) in the case of redemption due to the occurrence of a change in the regulatory classification of the relevant Dated Subordinated Debt Securities that occurs on or after the issue date of the Dated Subordinated Debt Securities and that does or would be likely to result in their exclusion from own funds or reclassification as a lower quality form of own funds, (i) the PRA considers such change to be sufficiently certain and (ii) we demonstrate to the satisfaction of the PRA that such change was not reasonably foreseeable at the time of the issuance of the relevant Dated Subordinated Debt Securities; or

(2) in the case of redemption due to the occurrence of a Tax Event, we demonstrate to the satisfaction of the PRA that there is a change in the applicable tax treatment of the Dated Subordinated Debt Securities that is material and was not reasonably foreseeable at the time of issuance of the relevant Dated Subordinated Debt Securities.

The rules under CRD IV may be modified from time to time after the date of issuance of the relevant Dated Subordinated Debt Securities.

"Capital Regulations" means, at any time, the laws, regulations, requirements, standards, guidelines and policies relating to capital adequacy for credit institutions of either (i) the PRA and/or (ii) any other national or European authority, in each case then in effect in the United Kingdom (or in such other jurisdiction in which we may be organized or domiciled) and applicable to the Group, including, as at the date hereof, CRD IV and related technical standards.

"CRD IV" means the legislative package consisting of Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, as the same may be amended or replaced from time to time, and Regulation (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms of the European Parliament and of the Council of June 26, 2013, as the same may be amended or replaced from time to time.

"own funds" means the sum of Tier 1 Capital and Tier 2 Capital.

"own funds instruments" means capital instruments issued by Barclays Bank PLC that qualify as Tier 1 Capital or Tier 2 Capital.

"Tier 1 Capital" means Tier 1 Capital for the purposes of the Capital Regulations.

"Tier 2 Capital" means Tier 2 Capital for the purposes of the Capital Regulations.

Notice of Redemption

Unless the relevant prospectus supplement provides otherwise, any redemption of debt securities shall be subject to our giving not less than thirty (30) days', nor more than sixty (60) days', prior notice to the holders of such notes via DTC (or, if the notes are held in definitive form, to the holders at their addresses shown on the register for the notes) (such notice being irrevocable except in the limited circumstances described in the following paragraph) specifying our election to redeem such notes and the date fixed for such redemption. Notice by DTC to participating institutions and by these participants to street name holders of beneficial interests in the relevant notes will be made according to arrangements among them and may be subject to statutory or regulatory requirements.

If the Issuer has elected to redeem any debt securities but prior to the payment of the redemption amount with respect to such redemption the relevant U.K. resolution authority exercises its U.K. Bail-in Power in respect of the debt securities, the relevant redemption notice shall be automatically rescinded and shall be of no force and effect, and no payment of the redemption amount will be due and payable.

Condition to Repurchase

Unless the applicable prospectus supplement specifies otherwise, we or any member of the Group may purchase or otherwise acquire any outstanding debt securities of any series at any price in the open market or otherwise, subject to the following sentence and to applicable law. Repurchases of Dated Subordinated Debt Securities must be (i) in accordance with the Capital Regulations applicable to the Group in force at the relevant time, (ii) subject to the prior consent of the PRA (if such consent is then required by the Capital Regulations) and (iii) with all unmatured coupons appertaining thereto.

We will treat as cancelled and no longer issued and outstanding any debt securities of any series that we purchase beneficially for our own account, other than a purchase in the ordinary course of a business dealing in securities. Unless otherwise specified in the applicable prospectus supplement, you have no right to require us to repurchase the debt securities. Such debt securities will stop bearing interest on the repurchase date, even if you do not collect your money.

Convertible or Exchangeable Securities

Unless the applicable prospectus supplement specifies otherwise, optionally convertible or exchangeable securities will entitle the holder, during a period, or at specific times, to convert or exchange optionally convertible or exchangeable securities into or for the underlying security, basket or baskets of securities, index or indices of securities, or a combination of these, at a specified rate of exchange. Optionally convertible or exchangeable securities will be redeemable at our option prior to maturity, if the applicable prospectus supplement so states. If a holder does not elect to convert or exchange the optionally convertible or exchangeable securities before maturity or any applicable redemption date, the holder will receive the principal amount of the optionally convertible or exchangeable securities.

Unless the applicable prospectus supplement specifies otherwise, the holder is not entitled to convert or exchange mandatorily convertible or exchangeable securities before maturity. At maturity, the holder must convert or exchange the mandatorily convertible or exchangeable securities for the underlying security, basket or baskets of securities or index or indices of securities, or a combination of these, at a specified rate of exchange, and, therefore, the holder may receive less than the principal amount of the mandatorily convertible or exchangeable security. If the applicable prospectus supplement so indicates, the specified rate at which a mandatorily convertible or exchangeable security will be converted or exchanged may vary depending on the value of the underlying securities, basket or baskets of securities, index or indices of securities, or a combination of these so that, upon conversion or exchange, the holder participates in a percentage, which may be other than 100%, of the change in value of the underlying securities, basket or baskets, index or indices of securities, or a combination of these.

Unless the applicable prospectus supplement specifies otherwise, upon conversion or exchange, at maturity or otherwise, the holder of a convertible or exchangeable security may receive, at the specified exchange rate, either the underlying security or the securities constituting the relevant basket or baskets, index or indices, or a combination of these, or the cash value thereof.

Modification and Waiver

We and the trustee may make certain modifications and amendments to the indenture applicable to each series of debt securities without the consent of the holders of the debt securities. We may make other modifications and amendments with the consent of the holder(s) of not less than, in the case of the Senior Debt Securities, a majority of or, in the case of the Dated Subordinated Debt Securities, 66 2/3% in aggregate principal amount of the debt securities of the series outstanding under the applicable indenture that are affected by the modification or amendment. However, we may not make any modification or amendment without the consent of the holder of each affected debt security that would:

- change the terms of any debt security to change the stated maturity date of its principal amount;
- change the principal amount of, or any premium or rate of interest, with respect to any debt securities;
- reduce the amount of principal on a Discount Security that would be due and payable upon an acceleration of the maturity date of any series of debt securities;
- change our obligation, or any successor's, to pay Additional Amounts, if any;
- change the places at which payments are payable or the currency of payment;
- impair the right to sue for the enforcement of any payment due and payable, to the extent that such right exists;
- reduce the percentage in aggregate principal amount of outstanding debt securities of the series necessary to modify or amend the indenture or to waive compliance with certain provisions of the indenture and any past Senior Event of Default or Dated Subordinated Event of Default (in each case as defined below);

- change our obligation to maintain an office or agency in the place and for the purposes specified in the indenture;

- modify the subordination provisions, if any, or the terms and conditions of our obligations in respect of the due and punctual payment of the amounts due and payable on the debt securities, in either case in a manner adverse to the holders; or

- modify the foregoing requirements or the provisions of the indenture relating to the waiver of any past Senior Event of Default, Dated Subordinated Event of Default or covenants, except as otherwise specified.

Unless the relevant prospectus supplement provides otherwise, in addition, any variations in the terms and conditions of Dated Subordinated Debt Securities of any series, including modifications relating to the subordination or redemption provisions of such Dated Subordinated Debt Securities, can only be made in accordance with the rules and requirements of the PRA, as and to the extent applicable from time to time.

Senior Events of Default; Dated Subordinated Enforcement Events and Remedies; Limitations on Suits

Senior Events of Default

Unless the relevant prospectus supplement provides otherwise, a "Senior Event of Default" with respect to any series of Senior Debt Securities shall result if:

- we do not pay any principal or interest on any Senior Debt Securities of that series within 14 days from the due date for payment and the principal or interest has not been duly paid within a further 14 days following written notice from the trustee or from holders of 25% in principal amount of the Senior Debt Securities of that series to us requiring the payment to be made. It shall not, however, be a Senior Event of Default if during the 14 days after the notice such sums ("Withheld Amounts") were not paid in order to comply with a law, regulation or order of any court of competent jurisdiction. Where there is doubt as to the validity or applicability of any such law, regulation or order, it shall not be a Senior Event of Default if we act on the advice given to us during the 14-day period by independent legal advisers approved by the trustee; or

- we breach any covenant or warranty of the Senior Debt Indenture (other than as stated above with respect to payments when due) and that breach has not been remedied within 21 days of receipt of a written notice from the trustee certifying that in its opinion the breach is materially prejudicial to the interests of the holders of the Senior Debt Securities of that series and requiring the breach to be remedied or from holders of at least 25% in principal amount of the Senior Debt Securities of that series requiring the breach to be remedied; or

- either an English court of competent jurisdiction issues an order which is not successfully appealed within 30 days, or an effective shareholders' resolution is validly adopted, for our winding-up (other than under or in connection with a scheme of reconstruction, merger or amalgamation not involving bankruptcy or insolvency).

If a Senior Event of Default occurs and is continuing, the trustee or the holders of at least 25% in outstanding principal amount of the Senior Debt Securities of that series may at their discretion declare the Senior Debt Securities of that series to be due and repayable immediately (and the Senior Debt Securities of that series shall thereby become due and repayable) at their outstanding principal amount (or at such other repayment amount as may be specified in or determined in accordance with the relevant prospectus supplement) together with accrued interest, if any, as provided in the prospectus supplement. The trustee may at its discretion and without further notice institute such proceedings as it may think suitable against us to enforce payment. Subject to the indenture provisions for the indemnification of the trustee, the holders of a majority in aggregate principal amount of the outstanding Senior Debt Securities of any series shall have the right to direct the time, method and place of conducting any proceeding in the name of and on the behalf of the trustee for any remedy available to the trustee or exercising any trust or power conferred on the trustee with respect to the series. However, this direction must not be in conflict with any rule of law or the Senior Debt Indenture, and must not be unjustly prejudicial to the holder(s) of any Senior Debt

Securities of that series not taking part in the direction, as determined by the trustee. The trustee may also take any other action, consistent with the direction, that it deems proper.

If lawful, Withheld Amounts or a sum equal to Withheld Amounts shall be placed promptly on interest bearing deposit as described in the Senior Debt Indenture. We will give notice if at any time it is lawful to pay any Withheld Amount to holders of Senior Debt Securities or holders of coupons or if such payment is possible as soon as any doubt as to the validity or applicability of the law, regulation or order is resolved. The notice will give the date on which the Withheld Amounts and the interest accrued on it will be paid. This date will be the earliest day after the day on which it is decided Withheld Amounts can be paid on which the interest bearing deposit falls due for repayment or may be repaid without penalty. On such date, we shall be bound to pay the Withheld Amounts together with interest accrued on it. For the purposes of this subsection, this date will be the due date for those sums. Our obligations under this paragraph are in lieu of any other remedy against us in respect of Withheld Amounts. Payment will be subject to applicable laws, regulations or court orders, but in the case of payment of any Withheld Amount, without prejudice to the provisions described under "—Additional Amounts." Interest accrued on any Withheld Amounts will be paid net of any taxes required by applicable law to be withheld or deducted and we shall not be obliged to pay any Additional Amount in respect of any such withholding or deduction.

The holders of a majority of the aggregate principal amount of the outstanding Senior Debt Securities of any affected series may waive any past Senior Event of Default with respect to the series, except any default in respect of either:

- the payment of principal of, or any premium or interest, on any Senior Debt Securities; or
- a covenant or provision of the relevant indenture which cannot be modified or amended without the consent of each holder of Senior Debt Securities of the series.

Subject to exceptions, the trustee may, without the consent of the holders, waive or authorize a Senior Event of Default if, in the opinion of the trustee, such waiver or authorization would not be materially prejudicial to the interests of the holders.

The trustee will, within 90 days of a default with respect to the Senior Debt Securities of any series, give to each affected holder of the Senior Debt Securities of the affected series notice of any default it knows about, unless the default has been cured or waived. However, except in the case of a default in the payment of the principal of, or premium, if any, or interest, if any, on the Senior Debt Securities, the trustee will be entitled to withhold notice if a trust committee of responsible officers of the trustee determine in good faith that withholding of notice is in the interest of the holders.

We are required to furnish to the trustee annually a statement as to our compliance with all conditions and covenants under the Senior Debt Indenture.

Notwithstanding any contrary provisions, nothing shall impair the right of a holder, absent the holder's consent, to sue for any payments due but unpaid with respect to the Senior Debt Securities.

Street name and other indirect holders should consult their banks or brokers for information on how to give notice or direction to or make a request of the trustee and how to waive a Senior Event of Default.

Dated Subordinated Enforcement Events and Remedies

Winding-up

Unless the relevant prospectus supplement provides otherwise, if a Winding-up Event occurs, subject to the subordination provisions set out in the relevant prospectus supplement, the outstanding principal amount of the Dated Subordinated Debt Securities together with any accrued but unpaid interest thereon will become immediately due and payable. A "Winding-up Event" with respect to the Dated Subordinated Debt Securities shall result if (i) a court of competent jurisdiction in England (or such other jurisdiction in which we may be organized) makes an order

for our winding-up which is not successfully appealed within 30 days of the making of such order, (ii) our shareholders adopt an effective resolution for our winding-up (other than, in the case of either (i) or (ii) above, under or in connection with a scheme of reconstruction, merger or amalgamation not involving a bankruptcy or insolvency) or (iii) following the appointment of an administrator of Barclays Bank PLC, the administrator gives notice that it intends to declare and distribute a dividend.

Non-payment

If we fail to pay any amount that has become due and payable under the Dated Subordinated Debt Securities and the failure continues for 14 days, the trustee may give us notice of such failure. If within a period of 14 days following the provision of such notice, the failure continues and has not been cured nor waived, the trustee may at its discretion and without further notice to us institute proceedings in England (or such other jurisdiction in which we may be organized) (but not elsewhere) for our winding-up and/or prove in our winding-up and/or claim in our liquidation or administration.

Limited remedies for breach of obligations (other than non-payment)

In addition to the remedies for non-payment provided above, the trustee may, without further notice, institute such proceedings against us as the trustee may think fit to enforce any term, obligation or condition binding on us under the Dated Subordinated Debt Securities or the Dated Subordinated Debt Indenture (other than any payment obligation under or arising from the Dated Subordinated Debt Securities or the Dated Subordinated Debt Indenture, including, without limitation, payment of any principal or interest) (a "Dated Subordinated Performance Obligation"); provided always that the trustee (acting on behalf of the holders of the Dated Subordinated Debt Securities) and the holders of the Dated Subordinated Debt Securities may not enforce, and may not be entitled to enforce or otherwise claim, against us any judgment or other award given in such proceedings that requires the payment of money by us, whether by way of damages or otherwise (a "Dated Subordinated Monetary Judgment"), except by proving such Dated Subordinated Monetary Judgment in our winding-up and/or by claiming such Dated Subordinated Monetary Judgment in our administration.

For the avoidance of doubt, the sole and exclusive manner by which the trustee (acting on behalf of the holders of the Dated Subordinated Debt Securities) and the holders of the Dated Subordinated Debt Securities may seek to enforce or otherwise claim a Dated Subordinated Monetary Judgment against us in connection with our breach of a Dated Subordinated Performance Obligation shall be by proving such Dated Subordinated Monetary Judgment in our winding-up and/or by claiming such Dated Subordinated Monetary Judgment in our administration. By its acquisition of the Dated Subordinated Debt Securities, each holder of the Dated Subordinated Debt Securities acknowledges and agrees that such holder will not seek to enforce or otherwise claim, and will not direct the trustee (acting on behalf of the holders of the Dated Subordinated Debt Securities) to enforce or otherwise claim, a Dated Subordinated Monetary Judgment against us in connection with our breach of a Dated Subordinated Performance Obligation, except by proving such Dated Subordinated Monetary Judgment in our winding-up and/or by claiming such Dated Subordinated Monetary Judgment in our administration.

No other remedies

Other than the limited remedies specified herein under "Dated Subordinated Enforcement Events and Remedies" above and subject to "Trust Indenture Act remedies" below, no remedy against us will be available to the trustee (acting on behalf of the holders of the Dated Subordinated Debt Securities) or the holders of the Dated Subordinated Debt Securities whether for the recovery of amounts owing in respect of such Dated Subordinated Debt Securities or under the Dated Subordinated Debt Indenture or in respect of any breach by us of any of our obligations under or in respect of the terms of such Dated Subordinated Debt Securities or under the Dated Subordinated Debt Indenture in relation thereto; provided, however, that such limitation shall not apply to our obligations to pay the fees and expenses of, and to indemnify, the trustee (including fees and expenses of trustee's counsel) and the trustee's rights to apply money collected to first pay its fees and expenses shall not be subject to the subordination provisions set forth in the Dated Subordinated Debt Indenture.

Trust Indenture Act remedies

Notwithstanding the limitation on remedies specified herein under "Dated Subordinated Enforcement Events and Remedies" above, (1) the trustee will have such powers as are required to be authorized to it under the Trust Indenture Act in respect of the rights of the holders of the Dated Subordinated Debt Securities under the provisions of the Dated Subordinated Debt Indenture and (2) nothing shall impair the right of a holder of the Dated Subordinated Debt Securities under the Trust Indenture Act, absent such holder's consent, to sue for any payment due but unpaid with respect to the Dated Subordinated Debt Securities; provided that, in the case of each of (1) and (2) above, any payments in respect of, or arising from, the Dated Subordinated Debt Securities, including any payments or amounts resulting or arising from the enforcement of any rights under the Trust Indenture Act in respect of the Dated Subordinated Debt Securities, are subject to the subordination provisions set forth in the Dated Subordinated Debt Indenture.

Subject to applicable law and unless the applicable prospectus supplement provides otherwise, claims in respect of any Dated Subordinated Debt Security may not be set-off, or be the subject of a counterclaim, by the trustee or any holder against or in respect of any of its obligations to us, and the trustee and every holder will be deemed to have waived any right of set-off or counterclaim in respect of the Dated Subordinated Debt Securities or the Dated Subordinated Debt Indenture that they might otherwise have against us. No holder of Dated Subordinated Debt Securities shall be entitled to proceed directly against us except as described in "—Limitation on Suits" below.

Trustee's Duties—Dated Subordinated Debt Securities

In case of a Dated Subordinated Event of Default under any series of the Dated Subordinated Debt Securities, the trustee shall exercise such of the rights and powers vested in it by the Dated Subordinated Debt Indenture, and use the same degree of care and skill in their exercise, as a prudent person would exercise or use under the circumstances in the conduct of his or her own affairs. For these purposes, a "Dated Subordinated Event of Default" shall occur (i) upon a Winding-Up Event that occurs, (ii) if we fail to pay any amount that has become due and payable under any series of the Dated Subordinated Debt Securities and such failure continues for 14 days (as described under "Dated Subordinated Enforcement Events and Remedies—Non-payment") or (iii) upon a breach by us of a Dated Subordinated Performance Obligation with respect to a series of the Dated Subordinated Debt Securities (as described under "Dated Subordinated Enforcement Events and Remedies—Limited remedies for breach of obligations (other than non-payment)"). Holders of a majority of the aggregate principal amount of the outstanding Dated Subordinated Debt Securities of a series may not waive any past Dated Subordinated Event of Default specified in clauses (i) and (ii) in the preceding sentence.

If a Dated Subordinated Event of Default occurs and is continuing with respect to any series of the Dated Subordinated Debt Securities, the trustee will have no obligation to take any action at the direction of any holders of such series of the Dated Subordinated Debt Securities, unless they have offered the trustee security or indemnity satisfactory to the trustee in its sole discretion. The holders of a majority in aggregate principal amount of the outstanding Dated Subordinated Debt Securities of a series shall have the right to direct the time, method and place of conducting any proceeding in the name of and on the behalf of the trustee for any remedy available to the trustee or exercising any trust or power conferred on the trustee with respect to such series of the Dated Subordinated Debt Securities. However, this direction (a) must not be in conflict with any rule of law or the Dated Subordinated Debt Indenture and (b) must not be unjustly prejudicial to the holder(s) of such series of the Dated Subordinated Debt Securities not taking part in the direction, as determined by the trustee in its sole discretion. The trustee may also take any other action, not inconsistent with the direction, that it deems proper.

The trustee will, within 90 days of a Dated Subordinated Event of Default with respect to the Dated Subordinated Debt Securities of any series, give to each affected holder of the Dated Subordinated Debt Securities of the affected series notice of any Dated Subordinated Event of Default known to a responsible officer of the trustee, unless the Dated Subordinated Event of Default has been cured or waived. However, the trustee will be entitled to withhold notice if a trust committee of responsible officers of the trustee determine in good faith that withholding of notice is in the interest of the holders.

We are required to furnish to the trustee annually a statement as to our compliance with all conditions and covenants under the Dated Subordinated Debt Indenture.

Limitation on Suits

Before a holder may bypass the trustee and bring its own lawsuit or other formal legal action or take other steps to enforce its rights or protect its interests relating to the debt securities, the following must occur:

- The holder must give the trustee written notice that a Senior Event of Default or Dated Subordinated Event of Default has occurred and remains uncured.

- The holders of 25% in principal amount of all outstanding debt securities of the relevant series must make a written request that the trustee take action because of the default, and the holder must offer reasonable indemnity to the trustee against the cost and other liabilities of taking that action.

- The trustee must not have taken action for 60 days after receipt of the above notice and offer of indemnity, and the trustee must not have received an inconsistent direction from the majority in principal amount of all outstanding debt securities of the relevant series during that period.

- With respect to Senior Debt Securities, in the case of our winding-up in England, such legal action or proceeding is in the name and on behalf of the trustee to the same extent, but no further, as the trustee would have been entitled to do.

Notwithstanding any contrary provisions, nothing shall impair the right of a holder, absent the holder's consent, to sue for any payments due but unpaid with respect to the debt securities.

Street name and other indirect holders should consult their banks or brokers for information on how to give notice or direction to or make a request of the trustee and how to waive any past Dated Subordinated Event of Default.

Consolidation, Merger and Sale of Assets; Assumption

We may, without the consent of the holders of any of the debt securities, consolidate or amalgamate with, merge into or transfer or lease our assets substantially as an entirety to, any of the persons specified in the applicable indenture. However, any successor corporation formed by any consolidation, amalgamation or merger, or any transferee or lessee of our assets, must be a bank organized under the laws of the United Kingdom that assumes our obligations on the debt securities and the applicable indenture, and a number of other conditions must be met.

Subject to applicable law and regulation (including, if and to the extent required by the Capital Regulations at such time, the prior consent of the PRA), any of our wholly owned subsidiaries (or, with respect to the Dated Subordinated Debt Securities, Barclays PLC) may assume our obligations under the debt securities of any series without the consent of any holder (the "Substituted Issuer"). We, however, must irrevocably guarantee (on a subordinated basis in substantially the manner described under "—Ranking" above, in the case of Dated Subordinated Debt Securities) the obligations of the Substituted Issuer under the debt securities of that series. If we do, all of our direct obligations under the debt securities of the series and the applicable indenture shall immediately be discharged. Unless the relevant prospectus supplement provides otherwise, any Additional Amounts under the debt securities of the series will be payable in respect of taxes imposed by the jurisdiction in which the successor entity is organized, rather than taxes imposed by a U.K. taxing jurisdiction, subject to exceptions equivalent to those that apply to any obligation to pay Additional Amounts in respect of taxes imposed by a U.K. taxing jurisdiction. However, if we make payment under this guarantee, we shall also be required to pay Additional Amounts related to taxes (subject to the exceptions set forth in "—Additional Amounts" above) imposed by a U.K. taxing jurisdiction due to this guarantee payment. A subsidiary that assumes our obligations will also be entitled to redeem the debt securities of the relevant series in the circumstances described under "—Redemption" above with respect to any change or amendment to, or change in the application or interpretation of the laws or regulations (including any

treaty) of the assuming corporation's jurisdiction of incorporation as long as the change or amendment occurs after the date of the subsidiary's assumption of our obligations.

The U.S. Internal Revenue Service might deem an assumption of our obligations as described above to be an exchange of the existing debt securities for new debt securities, resulting in a recognition of taxable gain or loss and possibly other adverse tax consequences. Investors should consult their tax advisors regarding the tax consequences of such an assumption.

Governing Law

Unless the applicable prospectus supplement specifies otherwise, the debt securities and indentures will be governed by and construed in accordance with the laws of the State of New York, except that, as specified in the Dated Subordinated Debt Indenture, the subordination provisions and any applicable provisions relating to waiver of set-off of each series of Dated Subordinated Debt Securities and the related provisions in the Dated Subordinated Debt Indenture will be governed by and construed in accordance with the laws of England.

Notices

Notices regarding the debt securities will be valid:

- with respect to global debt securities in bearer form, if in writing and delivered or mailed to each direct holder;
- in the case of Dated Subordinated Debt Securities, with respect to global debt securities if given in accordance with the applicable procedures of the depositary for such global debt securities; or
- if registered debt securities are affected, if given in writing and mailed to each direct holder as provided in the applicable indenture; or
- with respect to bearer definitive debt securities, if published at least once in an Authorized Newspaper (as defined in the indentures) in the Borough of Manhattan in New York City and as the applicable prospectus supplement may specify otherwise.

Any notice shall be deemed to have been given on the date of such publication or, if published more than once, on the date of the first publication. If publication is not practicable, notice will be valid if given in any other manner, and deemed to have been given on the date, as we shall determine. With respect to a global debt security representing any series of debt securities, a copy of all notices with respect to such series will be delivered to the depositary for such global debt security.

The Trustee

The Bank of New York Mellon will be the trustee under the indentures. The trustee has two principal functions:

- first, it can enforce a holder's rights against us if we default on debt securities issued under the indentures. There are some limitations on the extent to which the trustee acts on a holder's behalf, described under "Senior Events of Default; Dated Subordinated Enforcement Events and Remedies; Limitation on Suits"; and
- second, the trustee performs administrative duties for us, such as sending the holder's interest payments, transferring debt securities to a new buyer and sending notices to holders.

We and some of our subsidiaries maintain deposit accounts and conduct other banking transactions with the trustee in the ordinary course of our respective businesses.

Consent to Service

The Senior Debt Indenture provides that we irrevocably designate Barclays Bank PLC (New York Branch), 745 Seventh Avenue, New York, New York 10019, Attention: General Counsel as our authorized agent for service of process in any proceeding arising out of or relating to the Senior Debt Indenture or Senior Debt Securities brought in any federal or state court in New York City, and we irrevocably submit to the jurisdiction of these courts.

The Dated Subordinated Debt Indenture provides that we irrevocably designate Barclays Bank PLC (New York Branch), 745 Seventh Avenue, New York, New York 10019, Attention: General Counsel as our authorized agent for service of process in any proceeding arising out of or relating to the Dated Subordinated Debt Indenture or Dated Subordinated Debt Securities brought in any federal or state court in the Borough of Manhattan, New York City, and we irrevocably submit to the jurisdiction of these courts.

DESCRIPTION OF WARRANTS

The following is a summary of the general terms of the warrants. It sets forth possible terms and provisions for each series of warrants. Each time that we offer warrants, we will prepare and file a prospectus supplement with the SEC, which you should read carefully. The prospectus supplement may contain additional terms and provisions of those securities. If there is any inconsistency between the terms and provisions presented here and those in the prospectus supplement, those in the prospectus supplement will apply and will replace those presented here.

We will issue each series of warrants under either an indenture between us and The Bank of New York Mellon, as trustee, or a warrant agreement between us and the applicable warrant agent. The terms of the warrants include those stated in the relevant indenture or agreement and any supplements thereto. We have filed each of the form of warrant indenture and warrant agreement as an exhibit to the registration statement, of which this prospectus is a part. If we issue a series of warrants under a warrant agreement, we will file that agreement either as an exhibit to an amendment to the registration statement of which this prospectus is a part or as an exhibit to a current report on Form 6-K.

Because this section is a summary, it does not describe every aspect of the warrants in detail. This summary is subject to, and qualified by reference to, all of the definitions and provisions of the relevant indenture or agreement, any supplement to the relevant indenture or agreement and each series of warrants. Certain terms, unless otherwise defined here, have the meaning given to them in the relevant indenture or agreement.

General

We may issue warrants that are debt warrants or universal warrants. We will issue each series of warrants under either a warrant indenture or a warrant agreement. We may offer warrants separately or together with our debt securities. When we refer to a series of warrants, we mean all warrants issued as part of the same series under the applicable indenture or agreement. We may issue warrants in such amounts or in as many distinct series as we wish.

Debt Warrants

We may issue warrants for the purchase of our debt securities on terms to be determined at the time of sale. We refer to this type of warrant as a “debt warrant.”

Universal Warrants

We may also issue warrants, on terms to be determined at the time of sale, for the purchase or sale of, or whose cash value is determined by reference to the performance, level or value of, one or more of the following:

- securities of one or more issuers, including our preferred stock or other securities (other than our ordinary shares or ordinary shares of Barclays PLC) described in this prospectus or debt or equity securities of third parties;
- one or more currencies;
- one or more commodities;
- any other financial, economic or other measure or instrument, including the occurrence or non-occurrence of any event or circumstance; and
- one or more indices or baskets of the items described above.

We refer to this type of warrant as a “universal warrant.” When we refer to “warrant property,” we mean such of each property described in the first four bullet points above as may be purchased or sold pursuant to a warrant, or by reference to which the cash value of a warrant is determined or linked.

We may satisfy our obligations, if any, and the holder of a universal warrant may satisfy its obligations, if any, with respect to any universal warrants by delivering:

- the warrant property;
- the cash value of the warrant property; or
- the cash value of the warrants determined by reference to the performance, level or value of the warrant property.

The prospectus supplement will describe what we may deliver to satisfy our obligations, if any, and what the holder of a universal warrant may deliver to satisfy its obligations, if any, with respect to any universal warrants.

Agreement with Respect to the Exercise of U.K. Bail-in Power

Notwithstanding any other agreements, arrangements or understandings between us and any holder of the warrants, by acquiring the warrants, each holder of the warrants acknowledges, accepts, agrees to be bound by, and consents to the exercise of, any U.K. Bail-in Power (as defined below) by the relevant U.K. resolution authority (as defined below) that may result in (i) the reduction or cancellation of all, or a portion, of the principal amount of, interest on, or any other amounts payable on, the warrants; (ii) the conversion of all, or a portion, of the principal amount of, interest on, or any other amounts payable on, the warrants into shares or other securities or other obligations of the Issuer or another person (and the issue to, or conferral on, the holder of the warrants such shares, securities or obligations); and/or (iii) the amendment or alteration of the maturity of the warrants, or amendment of the amount of interest or any other amounts due on the warrants, or the dates on which interest or any other amounts become payable, including by suspending payment for a temporary period; which U.K. Bail-in Power may be exercised by means of a variation of the terms of the warrants solely to give effect to the exercise by the relevant U.K. resolution authority of such U.K. Bail-in Power. Each holder of the warrants further acknowledges and agrees that the rights of the holders of the warrants are subject to, and will be varied, if necessary, solely to give effect to, the exercise of any U.K. Bail-in Power by the relevant U.K. resolution authority. For the avoidance of doubt, this consent and acknowledgment is not a waiver of any rights holders of the warrants may have at law if and to the extent that any U.K. Bail-in Power is exercised by the relevant U.K. resolution authority in breach of laws applicable in England.

For purposes of the warrants, a "U.K. Bail-in Power" is any write-down, conversion, transfer, modification and/or suspension power existing from time to time under any laws, regulations, rules or requirements relating to the resolution of banks, banking group companies, credit institutions and/or investment firms incorporated in the United Kingdom in effect and applicable in the United Kingdom to the Issuer or other members of the Group, including but not limited to any such laws, regulations, rules or requirements that are implemented, adopted or enacted within the context of any applicable European Union directive or regulation of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms, and/or within the context of a U.K. resolution regime under the Banking Act pursuant to which obligations of a bank, banking group company, credit institution or investment firm or any of its affiliates can be reduced, cancelled, amended, transferred and/or converted into shares or other securities or obligations of the obligor or any other person (and a reference to the "relevant U.K. resolution authority" is to any authority with the ability to exercise a U.K. Bail-in Power).

The relevant prospectus supplement may describe related provisions with respect to the U.K. Bail-in Power, including certain waivers by the holders of warrants of certain claims against the trustee, to the extent permitted by the Trust Indenture Act.

Legal Ownership; Form of Warrants

Street Name and Other Indirect Holders. Investors who hold warrants in accounts at banks or brokers will generally not be recognized by us as legal holders of warrants. This is called holding in "street name."

Instead, we would recognize only the bank or broker, or the financial institution the bank or broker uses to hold its warrants. These intermediary banks, brokers and other financial institutions pass along warrant property and other payments on the warrants, either because they agree to do so in their customer agreements or because they are legally required. An investor who holds warrants in street name should check with the investor's own intermediary institution to find out:

- how it handles warrant payments or delivers warrant property and notices;
- whether it imposes fees or charges;
- how it would handle voting if it were ever required;
- whether and how the investor can instruct it to send the investor's warrants, registered in the investor's own name so the investor can be a direct holder as described below; and
- how it would pursue rights under the warrants if there were a default or other event triggering the need for holders to act to protect their interests.

Direct Holders. Our obligations, as well as the obligations of the trustee or any warrant agent and those of any third parties employed by us or the trustee or any warrant agent, under the warrants, the warrant indenture and any warrant agreement run only to persons who are registered as holders of warrants. As noted above, we do not have obligations to an investor who holds in street name or other indirect means, either because the investor chooses to hold warrants in that manner or because the warrants are issued in the form of global securities as described below. For example, once we make payment to the registered holder, we have no further responsibility for the payment even if that holder is legally required to pass the payment along to the investor as a street name customer but does not do so.

Global Securities. A global security is a special type of indirectly held security, as described above under "—Legal Ownership; Form of Warrants—Street Name and Other Indirect Holders." If we issue warrants in the form of global securities, the ultimate beneficial owners can only be indirect holders.

We require that the global security be registered in the name of a financial institution we select. In addition, we require that the warrants included in the global security not be transferred to the name of any other direct holder unless the special circumstances described in the section "Global Securities" occur. The financial institution that acts as the sole direct holder of the global security is called the depositary. Any person wishing to own a security must do so indirectly by virtue of an account with a broker, bank or other financial institution that in turn has an account with the depositary. Unless the applicable prospectus supplement indicates otherwise, each series of warrants will be issued only in the form of global securities.

Further details of legal ownership are discussed in the section "Global Securities" below.

In the remainder of this description "holder" means direct holders and not street name or other indirect holders of warrants. Indirect holders should read the subsection entitled "—Legal Ownership; Form of Warrants—Street Name and Other Indirect Holders."

General Terms of Warrants

Because we are a holding company, our ability to perform our obligations on the warrants will depend in part on our ability to participate in distributions of assets from our subsidiaries. We discuss these matters above under "Description of Debt Securities—General."

Neither the indenture nor any warrant agreement limits the number of warrants that we may issue.

The prospectus supplement will indicate, where applicable, for each series or of two or more related series of warrants:

- the specific designation and aggregate number of, the warrants;
- the prices at which we will issue the warrants;
- the currency with which the warrants may be purchased;
- the date on which the right to exercise the warrants will begin and the date on which that right will expire or, if the warrants may not be continuously exercised throughout that period, the specific date or dates on which the warrants may be exercised;
- the minimum number, if any, of warrants that must be exercised at any one time, other than upon automatic exercise, if applicable;
- the maximum number, if any, of warrants that may be exercised on any exercise date or during any exercise period, as applicable;
- any provisions for the automatic exercise of the warrants at expiration or otherwise;
- in the case of universal warrants, if the warrant property is an index or a basket of securities, a description of the index or basket of securities, as the case may be;
- in the case of universal warrants, if the warrant property is an index, a description of the method of providing for a substitute index or indices or otherwise determining the amount payable if any index changes or ceases to be made available by its publisher;
- if applicable, the period or periods within which, the price or prices at which and the terms and conditions upon which we may redeem any warrants of the series at our option, in whole or in part and, if other than by a board resolution, the manner in which such election is evidenced;
- the indenture or agreement under which we will issue the warrants;
- whether the warrants will be registered securities or bearer securities or both;
- if applicable, that any warrants shall be issuable in whole or in part in the form of one or more global securities and, in such case, the respective depositaries;
- the identities of the trustee or warrant agent, any depositaries and any paying, transfer, calculation or other agents for the warrants;
- any listing of the warrants on a securities exchange; and
- any other terms of the warrants.

If we issue warrants in bearer form, the special restrictions and considerations relating to such bearer warrants, including applicable offering restrictions and U.S. tax considerations, will be described in the relevant prospectus supplement.

No holder of a warrant will have any rights of a holder of the warrant property purchasable or deliverable under the warrant.

Holders of warrants have no voting rights except as explained below under "—Modification and Waiver" and "—Warrant Events of Default; Limitation of Remedies."

Our affiliates may resell warrants in market-making transactions after their initial issuance. We discuss these transactions above under "Description of Debt Securities—General—Market-Making Transactions."

Additional Terms of Warrants

Debt Warrants

The prospectus supplement will further indicate, for each series or two or more related series of debt warrants:

- the designation, aggregate principal amount, currency and terms of the debt securities that may be purchased upon exercise of the debt warrants;
- the exercise price and whether the exercise price may be paid in cash, by the exchange of any debt warrants or other securities or both and the method of exercising the debt warrants; and
- the designation, terms and amount of debt securities, if any, to be issued together with each of the debt warrants and the date, if any, after which the debt warrants and debt securities will be separately transferable.

Universal Warrants

The prospectus supplement will further indicate for each series or two or more related series of universal warrants:

- whether the universal warrants are call warrants or put warrants, including in either case warrants that may be settled by means of net cash settlement or cashless exercise, or any other type of warrants;
- the specific warrant property, as well as the amount or the method for determining the amount of the warrant property purchasable or saleable upon the exercise of each warrant;
- the price at which and the currency with which the warrant property may be purchased or sold by or on behalf of the holder of each universal warrant upon the exercise of that warrant, or the method of determining that price;
- whether the exercise price may be paid in cash, by the exchange of any universal warrants or other securities or both, and the method of exercising the universal warrants; and
- whether the exercise of the universal warrants is to be settled in cash or by delivery of the warrant property or both and whether the election of such form of settlement is to be at our option or at the option of the holder of such warrant.

General Provisions of Warrant Indenture

We may issue universal warrants under the warrant indenture. Warrants of this kind will not be secured by any property or assets of Barclays Bank PLC or its subsidiaries. Thus, by owning a warrant issued under the indenture, you hold one of our unsecured obligations.

Ranking

The warrants issued under the indenture will constitute our direct, unconditional, unsecured and unsubordinated obligations and will at all times rank *pari passu* without any preference among themselves. In the event of a winding-up or administration of the Issuer, the warrants will rank *pari passu* with all our other outstanding unsecured and unsubordinated obligations, present and future, except such obligations as are preferred by operation of law.

Redemption

Redemption for Tax Reasons. Unless the relevant prospectus supplement provides otherwise, we will have the option to redeem the warrants of any series upon not less than 30 nor more than 60 days' notice to the holders on any dates as are specified in the applicable prospectus supplement, if we determine that as a result of a change in or amendment to the laws or regulations of a taxing jurisdiction, including any treaty to which the taxing jurisdiction is a party, or a change in an official application or interpretation of those laws or regulations, including a decision of any court or tribunal, which becomes effective on or after the date of the applicable prospectus supplement (and, in the case of a successor entity, which becomes effective on or after the date of that entity's assumption of our obligations), we (or any successor entity) will become subject to any adverse tax consequences.

Before we give a notice of redemption, we shall be required to deliver to the trustee a written legal opinion of independent counsel of recognized standing, chosen by us, in a form satisfactory to the trustee, confirming that we are entitled to exercise our right of redemption. The redemption must be made in respect of all, but not some, of the warrants of the relevant series. The relevant pricing supplement will specify the applicable redemption price for the warrants.

Optional Redemption. The relevant prospectus supplement will specify whether we may redeem the warrants of any series, in whole or in part, at our option, in any other circumstances. The prospectus supplement will also specify the notice we will be required to give, what prices and any premium we will pay, and the dates on which we may redeem the warrants. Any notice of redemption of warrants will state:

- the date fixed for redemption;
- the redemption price;
- the amount of warrants to be redeemed if we are only redeeming a part of the series;
- that on the date fixed for redemption the redemption price will become due and payable on each warrant to be redeemed;
- the place or places at which each holder may obtain payment of the redemption price;
- if applicable, the terms of exercise, the date on which the right to exercise the warrant terminates and the place or places where such warrants may be surrendered for exercise; and
- the CUSIP number or numbers, if any, with respect to the warrants.

In the case of a partial redemption, the trustee shall select the warrants that we will redeem in any manner it deems fair and appropriate.

We or any of our subsidiaries may at any time purchase warrants of any series in the open market or by tender (available alike to each holder of warrants of the relevant series) or by private agreement, if applicable law allows. We will treat as cancelled and no longer issued and outstanding any warrants of any series that we purchase beneficially for our own account, other than a purchase in the ordinary course of a business dealing in securities.

Modification and Waiver

We and the trustee may make certain modifications and amendments to the indenture applicable to each series of warrants without the consent of the holders of the warrants. We may make other modifications and amendments with the consent of the holder(s) of not less than a majority in number of the warrants of the series outstanding under the indenture that are affected by the modification or amendment. However, we may not make any modification or amendment without the consent of the holder of each affected warrant that would:

- change the terms of any warrant with respect to the payment or settlement date of the warrant;

- change the exercise price of the warrant;

- reduce the amount of money payable or reduce the amount or change the kind of warrant property deliverable upon the exercise of the warrant or any premium payable upon redemption of the warrant;

- change the places at which payments are payable or the currency of payment;

- permit redemption of a warrant if not previously permitted;

- impair a holder's right to exercise its warrant, or sue for payment or delivery of any money or warrant property payable or deliverable with respect to its warrant on or after the payment or settlement date, or in the case of redemption, the redemption date;

- reduce the percentage in number of outstanding warrants of the series necessary to modify or amend the indenture or to waive compliance with certain provisions of the indenture and any past Warrant Event of Default (as defined below);

- change our obligation to maintain an office or agency in the place and for the purposes specified in the indenture;

- modify the terms and conditions of our obligations in respect of the due and punctual payment or delivery of money or warrant property due and payable or deliverable on the warrants, in a manner adverse to the holders; or

- modify the foregoing requirements or the provisions of the indenture relating to the waiver of any past Warrant Event of Default or covenants, except as otherwise specified.

Warrant Events of Default; Limitation of Remedies

Warrant Events of Default. Unless the relevant prospectus supplement provides otherwise, a "Warrant Event of Default" with respect to any warrant shall result if:

- we do not pay any money or deliver any warrant property with respect to that warrant on the payment or settlement date in accordance with the terms of that warrant. It shall not, however, be a Warrant Event of Default if we satisfy the trustee that such sums or warrant property ("Withheld Amounts") were not paid or delivered in order to comply with a law, regulation or order of any court of competent jurisdiction. Where there is doubt as to the validity or applicability of any such law, regulation or order, it shall not be a Warrant Event of Default if we act on the advice given to us during a 14-day period by independent legal advisers approved by the trustee; or

- we breach any covenant or warranty of the warrant indenture (other than as stated above with respect to payments when due) and that breach has not been remedied within 21 days of receipt of a written notice from the trustee requiring the breach to be remedied or from holders of at least 25% in number of the outstanding warrants of the relevant series requiring the breach to be remedied; or

- either an English court of competent jurisdiction issues an order which is not successfully appealed within 30 days, or an effective shareholders' resolution is validly adopted, for our winding-up (other than under or in connection with a scheme of reconstruction, merger or amalgamation not involving a bankruptcy or insolvency).

If a Warrant Event of Default occurs and is continuing, the trustee may at its discretion and without further notice institute such proceedings as it may think suitable, against us to enforce payment. Subject to the indenture provisions for the indemnification of the trustee, the holders of a majority in number of the outstanding warrants of any series shall have the right to direct the time, method and place of conducting any proceeding in the name of and on the

behalf of the trustee for any remedy available to the trustee or exercising any trust or power conferred on the trustee with respect to the series. However, this direction must not be in conflict with any rule of law or the warrant indenture, and must not be unjustly prejudicial to the holder(s) of any warrants of that series not taking part in the direction, as determined by the trustee. The trustee may also take any other action, consistent with the direction, that it deems proper.

If lawful, Withheld Amounts or a sum equal to Withheld Amounts shall be placed promptly on interest bearing deposit as described in the warrant indenture. We will give notice if at any time it is lawful to pay any Withheld Amount to holders of warrants or if such payment is possible as soon as any doubt as to the validity or applicability of the law, regulation or order is resolved. The notice will give the date on which the Withheld Amount and the interest accrued on it will be paid. This date will be the earliest day after the day on which it is decided Withheld Amounts can be paid on which the interest bearing deposit falls due for repayment or may be repaid without penalty. On such date, we shall be bound to pay the Withheld Amount together with interest accrued on it. For the purposes of this subsection, this date will be the due date for those sums. Our obligations under this paragraph are in lieu of any other remedy against us in respect of Withheld Amounts. Payment will be subject to applicable laws, regulations or court orders. Interest accrued on any Withheld Amount will be paid net of any taxes required by applicable law to be withheld or deducted.

The holders of a majority in number of the outstanding warrants of any affected series may waive any past Warrant Event of Default with respect to the series, except any default in respect of either:

- the payment or delivery of money or warrant property in respect of any warrant of the series; or
- a covenant or provision of the indenture which cannot be modified or amended without the consent of the holder of each outstanding warrant of the series.

Subject to exceptions, the trustee may, without the consent of the holders, waive or authorize a Warrant Event of Default if, in the opinion of the trustee, such waiver or authorization would not be materially prejudicial to the interests of the holders.

The trustee will, within 90 days of a default with respect to the warrants of any series, give to each affected holder of the warrants of the affected series notice of any default it knows about, unless the default has been cured or waived. However, except in the case of a default in the payment or delivery of any money or warrant property, the trustee will be entitled to withhold notice if the board of directors, the executive committee or a trust committee of directors or responsible officers of the trustee determine in good faith that withholding of notice is in the interest of the holders.

We will furnish to the trustee annually a statement as to our compliance with all conditions and covenants under the warrant indenture.

Limitation on suits. Before a holder may bypass the trustee and bring its own lawsuit or other formal legal action or take other steps to enforce its rights or protect its interests relating to the warrants, the following must occur:

- The holder must give the trustee written notice that an event of default has occurred and remains uncured.
- The holders of 25% in number of the outstanding warrants of the relevant series must make a written request that the trustee take action because of the default, and the holder must offer reasonable indemnity to the trustee against the cost and other liabilities of taking that action.
- The trustee must not have taken action for 60 days after receipt of the above notice and offer of indemnity, and the trustee must not have received an inconsistent direction from the majority in number of the outstanding warrants of the relevant series during that period.
- In the case of our winding-up in England, such legal action or proceeding is in the name and on behalf of the trustee to the same extent, but no further, as the trustee would have been entitled to do.

Notwithstanding any contrary provisions, nothing shall impair the right of a holder, absent the holder's consent, to sue for any payments or delivery of warrant property, as applicable, due but unpaid or not delivered with respect to the warrants.

Street name and other indirect owners should consult their banks or brokers for information on how to give notice or direction to or make a request of the trustee and how to waive any Warrant Event of Default.

Consolidation, Merger and Sale of Assets; Assumption

We may, without the consent of the holders of any of the warrants, consolidate with, merge into or transfer or lease our assets substantially as an entirety to, any of the persons specified in the indenture. However, any successor corporation formed by any consolidation or amalgamation, or any transferee or lessee of our assets, must be a bank organized under the laws of the United Kingdom that assumes our obligations on the warrants and the applicable indenture, and a number of other conditions must be met.

Subject to applicable law and regulation, any of our wholly owned subsidiaries may assume our obligations under the warrants of any series without the consent of any holder. We, however, must irrevocably guarantee the obligations of the subsidiary under the warrants of that series. If we do, all of our direct obligations under the warrants of the series and the applicable indenture shall immediately be discharged. A subsidiary that assumes our obligations will also be entitled to redeem the warrants of the relevant series in the circumstances described under "—Redemption" above with respect to any change or amendment to, or change in the application or interpretation of the laws or regulations (including any treaty) of the assuming corporation's jurisdiction of incorporation as long as the change or amendment occurs after the date of the subsidiary's assumption of our obligations.

The U.S. Internal Revenue Service might deem an assumption of our obligations as described above to be an exchange of the existing warrants for new warrants, resulting in a recognition of taxable gain or loss and possibly other adverse tax consequences. Investors should consult their tax advisors regarding the tax consequences of such an assumption.

Governing Law and Waiver of Jury Trial

The warrants and indenture will be governed by and construed in accordance with the laws of the State of New York. We and the trustee have agreed to waive the right to trial by jury with respect to any legal proceeding arising out of or relating to the warrant indenture or the warrants.

Notices

Notices regarding the warrants will be valid:

- with respect to global warrants in bearer form, if in writing and delivered or mailed to each direct holder;
- if registered warrants are affected, if given in writing and mailed to each direct holder as provided in the indenture; or
- with respect to bearer definitive warrants, if published at least once in an Authorized Newspaper (as defined in the indenture) in the Borough of Manhattan in New York City and as the applicable prospectus supplement may specify otherwise.

Any notice shall be deemed to have been given on the date of such publication or, if published more than once, on the date of the first publication. If publication is not practicable, notice will be valid if given in any other manner, and deemed to have been given on the date, as we shall determine. With respect to a global warrant representing any series of warrants, a copy of all notices with respect to such series will be delivered to the depositary for such global warrant.

Payment and Paying Agents

We will pay or deliver money or warrant property due on the warrants at the corporate trust office of the trustee in New York City. Holders of warrants must make arrangements to have their payments wired from or warrant property picked up at, as applicable, that office.

Street name and other indirect holders should consult their banks or brokers for information on how they will receive payments or deliveries of warrant property.

We may also arrange for additional payment offices, and may cancel or change these offices, including our use of the trustee's corporate trust office. These offices are called paying agents. We may also choose to act as our own paying agent. We must notify the trustee of changes in the paying agents for any particular series of warrants.

The Trustee

The Bank of New York Mellon will be the trustee under the indenture. The trustee has two principal functions:

- first, the trustee can enforce a holder's rights against us if we default under the indenture. There are some limitations on the extent to which the trustee acts on a holder's behalf, described under "—Warrant Events of Default; Limitation of Remedies"; and

- second, the trustee performs administrative duties for us, such as sending the holder's payments or warrant property, transferring warrants to a new buyer and sending notices to holders.

We and some of our subsidiaries maintain deposit accounts and conduct other banking transactions with the trustee in the ordinary course of our respective businesses.

The trustee will not be liable for special, indirect or consequential damages and will not be liable for any failure of its obligations caused by circumstances beyond its reasonable control.

Consent to Service

The indenture provides that we irrevocably designate Barclays Bank PLC, 745 Seventh Avenue, New York, New York 10019, Attention: General Counsel as our authorized agent for service of process in any proceeding arising out of or relating to the indenture or warrants brought in any federal or state court in New York City, and we irrevocably submit to the jurisdiction of these courts.

General Provisions of Warrant Agreements

We may issue debt warrants and some universal warrants in one or more series under one or more warrant agreements, each to be entered into between us and a bank or trust company as warrant agent. We may add, replace or terminate warrant agents from time to time. We may also choose to act as our own warrant agent. This section describes certain general provisions of the form of warrant agreement filed as an exhibit to the registration statement of which this prospectus is a part. The specific terms of the warrant agreement under which we issue any warrants will be described in the applicable prospectus supplement, and we will file that agreement with the SEC, either as an exhibit to an amendment to the registration statement of which this prospectus is a part or as an exhibit to a current report on Form 6-K. See "Where You Can Find More Information" below for information on how to obtain a copy of a warrant agreement when it is filed.

We may also issue universal warrants under the warrant indenture. For these warrants, the applicable provisions of the warrant indenture described above would apply instead of the provisions described in this section.

Enforcement of Rights

The warrant agent under a warrant agreement will act solely as our agent in connection with the warrants issued under that agreement. The warrant agent will not assume any obligation or relationship of agency or trust for or with any holders of those warrants. Any holder of warrants may, without the consent of any other person, enforce by appropriate legal action, on its own behalf, its right to exercise those warrants in accordance with their terms. No holder of any warrant will be entitled to any rights of a holder of the debt securities or warrant property purchasable or deliverable upon exercise of the warrant, including any right to receive payments on those debt securities or warrant property or to enforce any covenants or rights in the relevant indenture or any other agreement.

Modifications Without Consent of Holders

We and the applicable warrant agent may make certain amendments to any warrant or warrant agreement without the consent of any holder, including:

- to cure any ambiguity;
- to cure, correct or supplement any defective or inconsistent provision; or
- to make any other change that we believe is necessary or desirable and will not adversely affect the interests of the affected holders in any material respect.

We do not need any approval to make changes that affect only warrants to be issued after the changes take effect. We may also make changes that do not adversely affect a particular warrant in any material respect, even if they adversely affect other warrants in a material respect. In those cases, we do not need to obtain the approval of the holder of the unaffected warrant; we need only obtain any required approvals from the holders of the affected warrants.

Modifications with Consent of Holders

We may not amend any particular warrant or a warrant agreement with respect to any particular warrant unless we obtain the consent of the holder of each affected warrant, if the amendment would:

- change the amount of the warrant property or other consideration purchasable or saleable upon exercise of the warrant;
- change the exercise price of the warrant;
- shorten the period of time during which the holder may exercise the warrant;
- otherwise impair the holder's right to exercise the warrant in any material respect; or
- reduce the number of outstanding, unexpired warrants of any series or class the consent of whose holders is required to amend the series or class, or the applicable warrant agreement with regard to that series or class, as described below.

Any other change to a particular warrant agreement and the warrants issued under that agreement would require the following approval:

- If the change affects only the warrants of a particular series issued under that agreement, the change must be approved by the holders of a majority of the outstanding, unexpired warrants of that series.

- If the change affects the warrants of more than one series issued under that agreement, the change must be approved by the holders of a majority of all outstanding, unexpired warrants of all series affected by the change, with the warrants of all the affected series voting together as one class for this purpose.

Warrant Agreement Will Not Be Qualified Under the Trust Indenture Act

No warrant agreement will be qualified as an indenture, and no warrant agent will be required to qualify as a trustee, under the Trust Indenture Act. Therefore, holders of warrants issued under a warrant agreement will not have the protection of the Trust Indenture Act with respect to their warrants.

Mergers and Similar Transactions Permitted; No Restrictive Covenants or Events of Default

The warrant agreements and any warrants issued under the warrant agreements will not restrict our ability to merge or consolidate with, or sell, lease, transfer or convey our assets to, another corporation or other entity or to engage in any other transactions. Unless otherwise specified in the applicable pricing supplement, if at any time we merge or consolidate with, or sell our assets substantially as an entirety to, another corporation or other entity, the successor entity will succeed to and assume our obligations under the warrants and warrant agreements. We will then be relieved of any further obligation under the warrants and warrant agreements.

The warrant agreements and any warrants issued under the warrant agreements will not include any restrictions on our ability to put liens on our assets, including our interests in our subsidiaries, nor will they restrict our ability to sell our assets. The warrant agreements and any warrants issued under the warrant agreements also will not provide for any events of default or remedies upon the occurrence of any events of default.

Governing Law

Each warrant agreement and any warrants issued under the warrant agreements will be governed by New York law.

Notices

We or the applicable warrant agent will give notice to holders of warrants by mailing written notice by first class mail, postage prepaid, to such holders as their names and addresses appear in the books and records of the applicable warrant agent.

Payments

We will pay or deliver money or warrant property due on the warrants at the applicable warrant agent's office. The warrant agent will transmit such money or warrant property to or upon the order of the holder of the warrants.

GLOBAL SECURITIES

Special Investor Considerations for Global Securities

As an indirect holder, an investor's rights relating to a global security will be governed by the account rules of the investor's financial institution and of the depositary, as well as general laws relating to securities transfers. We do not recognize this type of investor as a holder of securities and instead deal only with the depositary that holds the global security.

Investors in securities that are issued only in the form of global securities should be aware that:

- they cannot get securities registered in their own name;
- they cannot receive physical certificates for their interests in securities;
- they will be a street name holder and must look to their own bank or broker for payments on the securities (or delivery of warrant property, if applicable) and protection of their legal rights relating to the securities, as explained earlier under "Description of Debt Securities—Legal Ownership; Form of Debt Securities—Street Name and Other Indirect Holders" and "Description of Warrants—Legal Ownership; Form of Warrants—Street Name and Other Indirect Holders";
- they may not be able to sell interests in the securities to some insurance companies and other institutions that are required by law to own their securities in the form of physical certificates;
- the depositary's policies will govern payments, transfers, exchange and other matters relating to their interest in the global security. We and the trustee have no responsibility for any aspect of the depositary's actions or for its records of ownership interests in the global security. We and the trustee also do not supervise the depositary in any way; and
- the depositary will require that interests in a global security be purchased or sold within its system using same-day funds.

Special Situations When a Global Security Will Be Terminated

In a few special situations described below, the global security will terminate and interests in it will be exchanged for physical certificates representing securities. After that exchange, the choice of whether to hold the securities directly or in street name will be up to the investor. Investors must consult their own bank or brokers to find out how to have their interests in a global security transferred to their own name so that they will be direct holders. The rights of street name investors and direct holders in the securities have been previously described in the sections entitled "Description of Debt Securities—Legal Ownership; Form of Debt Securities—Street Name and Other Indirect Holders; Direct Holders" and "Description of Warrants—Legal Ownership; Form of Warrants—Street Name and Other Indirect Holders; Direct Holders."

The special situations for termination of a global security are:

- when the depositary notifies us that it is unwilling, unable or no longer qualified to continue as depositary; and
- when a Senior Event of Default, in the case of Senior Debt Securities, a Dated Subordinated Event of Default, in the case of Dated Subordinated Debt Securities, or a Warrant Event of Default in the case of warrants issued under a warrant indenture, has occurred and has not been cured. Defaults are discussed above under "Description of Debt Securities—Senior Events of Default; Dated Subordinated Enforcement Events and Remedies; Limitation on Suits" and "Description of Warrants—General Provisions of Warrant Indenture—Warrant Events of Default; Limitation of Remedies."

The prospectus supplement may also list additional situations for terminating a global security that would apply only to the particular series of securities covered by the prospectus supplement. When a global security terminates, the depositary (and not us or the trustee) is responsible for deciding the names of the institutions that will be the initial direct holders.

CLEARANCE AND SETTLEMENT

The securities we issue may be held through one or more international and domestic clearing systems. The principal clearing systems we will use are the book-entry systems operated by DTC, in the United States, Clearstream Banking, société anonyme ("Clearstream, Luxembourg"), in Luxembourg and Euroclear Bank S.A./N.V. ("Euroclear"), in Brussels, Belgium. These systems have established electronic securities and payment transfer, processing, depositary and custodial links among themselves and others, either directly or through custodians and depositaries. These links allow securities to be issued, held and transferred among the clearing systems without the physical transfer of certificates.

Special procedures to facilitate clearance and settlement have been established among these clearing systems to trade securities across borders in the secondary market. Where payments for securities we issue in global form will be made in U.S. dollars, these procedures can be used for cross-market transfers and the securities will be cleared and settled on a delivery against payment basis.

Global securities will be registered in the name of a nominee for, and accepted for settlement and clearance by, one or more of Euroclear, Clearstream, Luxembourg, DTC and any other clearing system identified in the applicable prospectus supplement or pricing supplement.

Cross-market transfers of securities that are not in global form may be cleared and settled in accordance with other procedures that may be established among the clearing systems for these securities.

Euroclear and Clearstream, Luxembourg hold interests on behalf of their participants through customers' securities accounts in the names of Euroclear and Clearstream, Luxembourg on the books of their respective depositories, which, in the case of securities for which a global security in registered form is deposited with the DTC, in turn hold such interests in customers' securities accounts in the depositories' names on the books of the DTC.

The policies of DTC, Clearstream, Luxembourg and Euroclear will govern payments, transfers, exchange and other matters relating to the investor's interest in securities held by them. This is also true for any other clearance system that may be named in a prospectus supplement or pricing supplement.

Neither we nor the trustee nor any of our or its agents has any responsibility for any aspect of the actions of DTC, Clearstream, Luxembourg or Euroclear or any of their direct or indirect participants. Neither we nor the trustee nor any of our or its agents has any responsibility for any aspect of the records kept by DTC, Clearstream, Luxembourg or Euroclear or any of their direct or indirect participants. Neither we nor the trustee nor any of our or its agents supervise these systems in any way. This is also true for any other clearing system indicated in a prospectus supplement or pricing supplement.

DTC, Clearstream, Luxembourg, Euroclear and their participants perform these clearance and settlement functions under agreements they have made with one another or with their customers. Investors should be aware that DTC, Clearstream, Luxembourg, Euroclear and their participants are not obligated to perform these procedures and may modify them or discontinue them at any time.

The description of the clearing systems in this section reflects our understanding of the rules and procedures of DTC, Clearstream, Luxembourg and Euroclear as they are currently in effect. Those systems could change their rules and procedures at any time.

The Clearing Systems

DTC

DTC has advised us as follows:

- DTC is:

(1) a limited purpose trust company organized under the laws of the State of New York;

(2) a "banking organization" within the meaning of New York Banking Law;

(3) a member of the Federal Reserve System;

(4) a "clearing corporation" within the meaning of the New York Uniform Commercial Code; and

(5) a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act.

- DTC was created to hold securities for its participants and to facilitate the clearance and settlement of securities transactions between participants through electronic book-entry changes to accounts of its participants. This eliminates the need for physical movement of securities.

- Participants in DTC include securities brokers and dealers, banks, trust companies and clearing corporations and may include certain other organizations. DTC is partially owned by some of these participants or their representatives.

- Indirect access to the DTC system is also available to banks, brokers and dealers and trust companies that have custodial relationships with participants.

- The rules applicable to DTC and DTC participants are on file with the SEC.

Purchases of securities under the DTC system must be made by or through DTC direct participants, which will receive a credit for the securities on DTC's records. The ownership interest of each actual purchaser of each security ("beneficial owner") is in turn to be recorded on the DTC direct and DTC indirect participants' records. Beneficial owners will not receive written confirmation from DTC of their purchase. Beneficial owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the DTC direct or DTC indirect participant through which the beneficial owner entered into the transaction. Transfers of ownership interests in the securities are to be accomplished by entries made on the books of direct and indirect participants acting on behalf of beneficial owners. Beneficial owners will not receive certificates representing their ownership interests in securities, except in the event that use of the book-entry system for the securities is discontinued.

To facilitate subsequent transfers, all securities deposited by DTC direct participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or any other name as may be requested by an authorized representative of DTC. The deposit of securities with DTC and their registration in the name of Cede & Co. or any other DTC nominee do not affect any change in beneficial ownership. DTC has no knowledge of the actual beneficial owners of the securities; DTC's records reflect only the identity of the DTC direct participants to whose accounts those securities are credited, which may or may not be the beneficial owners. The DTC direct and DTC indirect participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to DTC direct participants, by DTC direct participants to DTC indirect participants, and by DTC direct participants and DTC indirect participants to beneficial owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial owners of securities may wish to take steps to augment the transmission to them of notices of significant events with respect to the securities, such as redemptions, tenders, defaults, and proposed amendments to the security documents. For example, beneficial owners of securities may wish to ascertain that the nominee holding the securities for their benefit has agreed to obtain and transmit notices to beneficial owners. In the alternative, beneficial owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

With respect to the securities that contain an option to redeem, redemption notices shall be sent to DTC. If less than all of the securities within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each DTC direct participant in the issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to securities unless authorized by a DTC direct participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an omnibus proxy to an issuer as soon as possible after the record date. The omnibus proxy assigns Cede & Co.'s consenting or voting rights to those direct participants to whose accounts securities are credited on the record date (identified in a listing attached to the omnibus proxy).

Redemption proceeds, distributions, and dividend payments on the securities will be made to Cede & Co., or any other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit DTC direct participants' accounts upon DTC's receipt of funds and corresponding detail information from issuer or agent, on payable date in accordance with their respective holdings shown on DTC's records. Payments by DTC participants to beneficial owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of that DTC participant and not of DTC, agent, or us, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or any other nominee as may be requested by an authorized representative of DTC) is the responsibility of issuer or agent, disbursement of those payments to DTC direct participants will be the responsibility of DTC, and disbursement of those payments to the beneficial owners will be the responsibility of DTC direct and DTC indirect participants.

A beneficial owner shall give notice to elect to have its securities purchased or tendered, through its participant, to an agent, and shall effect delivery of those securities by causing the DTC direct participant to transfer the DTC participant's interest in the securities, on DTC's records, to an agent. The requirement for physical delivery of securities in connection with an optional tender or a mandatory purchase will be deemed satisfied when the ownership rights in the securities are transferred by DTC direct participants on DTC's records and followed by a book-entry credit of tendered securities to the agent's DTC account.

DTC may discontinue providing its services as depositary with respect to the securities at any time by giving reasonable notice to issuer or agent. Under those circumstances, in the event that a successor depositary is not obtained, securities certificates are required to be printed and delivered.

We may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depositary). In that event, securities certificates will be printed and delivered to DTC.

Clearstream, Luxembourg

Clearstream, Luxembourg has advised us as follows:

- Clearstream, Luxembourg is a duly licensed bank organized as a société anonyme incorporated under the laws of Luxembourg and is subject to regulation by the Luxembourg Commission for the Supervision of the Financial Sector (*Commission de Surveillance du Secteur Financier*).

- Clearstream, Luxembourg holds securities for its customers and facilitates the clearance and settlement of securities transactions among them. It does so through electronic book-entry transfers between the accounts of its customers. This eliminates the need for physical movement of securities.

- Clearstream, Luxembourg provides other services to its customers, including safekeeping, administration, clearance and settlement of internationally traded securities and lending and borrowing of securities. It interfaces with the domestic markets in over 30 countries through established depositary and custodial relationships.

- Clearstream, Luxembourg's customers include worldwide securities brokers and dealers, banks, trust companies and clearing corporations and may include professional financial intermediaries. Its U.S. customers are limited to securities brokers and dealers and banks.

- Indirect access to the Clearstream, Luxembourg system is also available to others that clear through Clearstream, Luxembourg customers or that have custodial relationships with its customers, such as banks, brokers, dealers and trust companies.

Euroclear

Euroclear has advised us as follows:

- Euroclear is incorporated under the laws of Belgium as a bank and is subject to regulation by the Belgian Financial Services and Markets Authority (*L'Autorité des Services et Marchés Financiers*) and the National Bank of Belgium (*Banque Nationale de Belgique*).

- Euroclear holds securities for its customers and facilitates the clearance and settlement of securities transactions among them. It does so through simultaneous electronic book-entry delivery against payment, thereby eliminating the need for physical movement of certificates.

- Euroclear provides other services to its customers, including credit, custody, lending and borrowing of securities and tri-party collateral management. It interfaces with the domestic markets of several countries.

- Euroclear customers include banks, including central banks, securities brokers and dealers, trust companies and clearing corporations and may include certain other professional financial intermediaries.

- Indirect access to the Euroclear system is also available to others that clear through Euroclear customers or that have custodial relationships with Euroclear customers.

- All securities in Euroclear are held on a fungible basis. This means that specific certificates are not matched to specific securities clearance accounts.

Other Clearing Systems

We may choose any other clearing system for a particular series of securities. The clearance and settlement procedures for the clearing system we choose will be described in the applicable prospectus supplement or pricing supplement.

Primary Distribution

Unless the applicable prospectus supplement or pricing supplement states otherwise, we will issue the securities in global form and the distribution of the securities will be cleared through one or more of the clearing systems that we have described above or any other clearing system that is specified in the applicable prospectus supplement or pricing supplement. Payment for securities will be made on a delivery versus payment or free delivery basis. These payment procedures will be more fully described in the applicable prospectus supplement or pricing supplement.

Clearance and settlement procedures may vary from one series of securities to another according to the currency that is chosen for the specific series of securities. Customary clearance and settlement procedures are described below.

We will submit applications to the relevant system or systems for the securities to be accepted for clearance. The clearance numbers that are applicable to each clearance system will be specified in the prospectus supplement or pricing supplement.

Clearance and Settlement Procedures—DTC

DTC participants that hold securities through DTC on behalf of investors will follow the settlement practices applicable to United States corporate debt obligations in DTC's Same-Day Funds Settlement System.

Securities will be credited to the securities custody accounts of these DTC participants against payment in same-day funds, for payments in U.S. dollars, on the settlement date. For payments in a currency other than U.S. dollars, securities will be credited free of payment on the settlement date.

Clearance and Settlement Procedures—Euroclear and Clearstream, Luxembourg

We understand that investors that hold their securities through Euroclear or Clearstream, Luxembourg accounts will follow the settlement procedures that are applicable to conventional Eurobonds in registered form for securities.

Securities will be credited to the securities custody accounts of Euroclear and Clearstream, Luxembourg participants on the business day following the settlement date, for value on the settlement date. They will be credited either free of payment or against payment for value on the settlement date.

Secondary Market Trading

Trading Between DTC Participants

Secondary market trading between DTC participants will occur in the ordinary way in accordance with DTC's rules. Secondary market trading will be settled using procedures applicable to United States corporate debt obligations in DTC's Same-Day Funds Settlement System for securities.

If payment is made in U.S. dollars, settlement will be in same-day funds. If payment is made in a currency other than U.S. dollars, settlement will be free of payment. If payment is made other than in U.S. dollars, separate payment arrangements outside of the DTC system must be made between the DTC participants involved.

Trading Between Euroclear and/or Clearstream, Luxembourg Participants

We understand that secondary market trading between Euroclear and/or Clearstream, Luxembourg participants will occur in the ordinary way following the applicable rules and operating procedures of Euroclear and Clearstream, Luxembourg. Secondary market trading will be settled using procedures applicable to conventional Eurobonds in registered form for securities.

Trading Between a DTC Seller and a Euroclear or Clearstream, Luxembourg Purchaser

A purchaser of securities that are held in the account of a DTC participant must send instructions to Euroclear or Clearstream, Luxembourg at least one business day prior to settlement. The instructions will provide for the transfer of the securities from the selling DTC participant's account to the account of the purchasing Euroclear or Clearstream, Luxembourg participant. Euroclear or Clearstream, Luxembourg, as the case may be, will then instruct the common depositary for Euroclear and Clearstream, Luxembourg to receive the securities either against payment or free of payment.

The interests in the securities will be credited to the respective clearing system. The clearing system will then credit the account of the participant, following its usual procedures. Credit for the securities will appear on the next day, European time. Cash debit will be back-valued to, and the interest on the securities will accrue from, the value date, which would be the preceding day, when settlement occurs in New York. If the trade fails and settlement is not completed on the intended date, the Euroclear or Clearstream, Luxembourg cash debit will be valued as of the actual settlement date instead.

Euroclear participants or Clearstream, Luxembourg participants will need the funds necessary to process same-day funds settlement. The most direct means of doing this is to pre-position funds for settlement, either from cash or

from existing lines of credit, as for any settlement occurring within Euroclear or Clearstream, Luxembourg. Under this approach, participants may take on credit exposure to Euroclear or Clearstream, Luxembourg until the securities are credited to their accounts one business day later.

As an alternative, if Euroclear or Clearstream, Luxembourg has extended a line of credit to them, participants can choose not to pre-position funds and will instead allow that credit line to be drawn upon to finance settlement. Under this procedure, Euroclear participants or Clearstream, Luxembourg participants purchasing securities would incur overdraft charges for one business day (assuming they cleared the overdraft as soon as the securities were credited to their accounts). However, any interest on the securities would accrue from the value date. Therefore, in many cases, the investment income on securities that is earned during that one-business day period may substantially reduce or offset the amount of the overdraft charges. This result will, however, depend on each participant's particular cost of funds.

Because the settlement will take place during New York business hours, DTC participants will use their usual procedures to deliver securities to the depositary on behalf of Euroclear participants or Clearstream, Luxembourg participants. The sale proceeds will be available to the DTC seller on the settlement date. For the DTC participants, then, a cross-market transaction will settle no differently than a trade between two DTC participants.

Special Timing Considerations

You should be aware that you will only be able to make and receive deliveries, payments and other communications involving the securities through Clearstream, Luxembourg and Euroclear on days when those systems are open for business. Those systems may not be open for business on days when banks, brokers and other institutions are open for business in the United States.

In addition, because of time-zone differences, there may be problems with completing transactions involving Clearstream, Luxembourg and Euroclear on the same business day as in the United States. U.S. investors who wish to transfer their interests in the securities, or to receive or make a payment or delivery of the securities, on a particular day, may find that the transactions will not be performed until the next business day in Luxembourg or Brussels, depending on whether Clearstream, Luxembourg or Euroclear is used.

DESCRIPTION OF PREFERENCE SHARES

The following is a summary of the general terms of the preference shares of any series we may issue under this registration statement. Each time we issue preference shares we will prepare a prospectus supplement, which you should read carefully. The prospectus supplement relating to a series of preference shares or to a series of debt securities that are convertible into or exchangeable for the preference shares will summarize the terms of the preference shares of the particular series. Those terms will be set out in the resolutions establishing the series that our Board of Directors or an authorized committee adopt, and may be different from those summarized below. If so, the applicable prospectus supplement will state that, and the description of the preference shares of that series contained in the prospectus supplement will apply.

This summary does not purport to be complete and is subject to, and qualified by, our Articles of Association and the resolutions of the Board of Directors or an authorized committee. You should read our Articles of Association as well as those resolutions, which we have filed or will file with the SEC as an exhibit to the registration statement, of which this prospectus is a part. You should also read the summary of the general terms of the deposit agreement under which American Depositary Receipts ("ADRs") evidencing American Depositary Shares ("ADSs") that may represent preference shares may be issued, under the heading "Description of American Depositary Shares."

General

Under our Articles of Association, our Board of Directors or an authorized committee of the Board is empowered to provide for the issuance of U.S. dollar-denominated preference shares, in one or more series, if a resolution of our shareholders has authorized the allotment of such preference shares.

The resolutions providing for their issue, adopted by the Board of Directors or the authorized committee, will set forth the dividend rights, liquidation value per share, redemption provisions, voting rights, other rights, preferences, privileges, limitations and restrictions of the preference shares.

The preference shares of any series will be U.S. dollar-denominated in terms of nominal value, dividend rights and liquidation value per preference share. They will, when issued, be fully paid and non-assessable. For each preference share issued, an amount equal to its nominal value will be credited to our issued share capital account and an amount equal to the difference between its issue price and its nominal value will be credited to our share premium account. The applicable prospectus supplement will specify the nominal value of the preference shares. The preference shares of a series deposited under the deposit agreement referred to in the section "Description of American Depositary Receipts" will be represented by ADSs of a corresponding series, evidenced by ADRs of such series. The preference shares of such series may only be withdrawn from deposit in registered form. See "Description of American Depositary Receipts."

The preference shares of any series will have the dividend rights, rights upon liquidation, redemption provisions and voting rights described below, unless the relevant prospectus supplement provides otherwise. You should read the prospectus supplement for the specific terms of any series, including:

- the number of preference shares offered, the number of preference shares offered in the form of ADSs and the number of preference shares represented by each ADS;
- the public offering price of the series;
- the liquidation value per preference share of that series;
- the dividend rate, or the method of calculating it;
- the place where we will pay dividends;
- the dates on which dividends (if paid) will be payable;

- voting rights of that series of preference shares, if any;
- restrictions applicable to the sale and delivery of the preference shares;
- whether and under what circumstances we will pay additional amounts on the preference shares in the event of certain developments with respect to withholding tax or information reporting laws;
- any redemption, conversion or exchange provisions;
- whether the preference shares shall be issued as units with shares of a related series;
- any listing on a securities exchange; and
- any other rights, preferences, privileges, limitations and restrictions relating to the series.

The applicable prospectus supplement will also describe additional material U.S. and U.K. tax considerations that apply to any particular series of preference shares.

Preference shares will be issued in registered form and title to preference shares of a series will pass by transfer and registration on the register that the registrar shall keep at its office in the United Kingdom. For more information on such registration, you should read "—Registrar and Paying Agent." The registrar will not charge for the registration of transfer, but the person requesting it will be liable for any taxes, stamp duties or other governmental charges.

We may issue preference shares in more than one related series if necessary to ensure that we continue to be treated as part of the Group for U.K. tax purposes. The preference shares of any two or more related series will be issued as preference share units, unless the applicable prospectus supplement specifies otherwise, so that holders of any preference share units will effectively have the same rights, preferences and privileges, and will be subject to the same limitations and restrictions. The following characteristics, however, may differ:

- the aggregate amount of dividends;
- the aggregate amounts which may be payable upon redemption;
- the redemption dates;
- the rights of holders to deposit the preference shares under the deposit agreement; and
- the voting rights of holders.

You should read the applicable prospectus supplement for the characteristics relating to any preference shares issuable in two or more related series as a unit.

Unless the applicable prospectus supplement specifies otherwise, the preference shares of each series will rank equally as to participation in our profits and assets with the preference shares of each other series.

Our affiliates may resell preferred shares after their initial issuance in market-making transactions. We describe these transactions above under "Description of Debt Securities—General—Market-Making Transactions."

Dividend Rights

The holders of the preference shares will be entitled to receive cash dividends on the dates and at the rates as described in the applicable prospectus supplement out of our "distributable profits." Except as provided in this prospectus and in the applicable prospectus supplement, holders of preference shares will have no right to participate in our profits.

For information concerning the declaration of dividends out of our distributable profits, see "Description of Share Capital—Ordinary Shares—Dividend Rights."

We will pay the dividends on the preference shares of a series to the record holders as they appear on the register on the record dates. A record date will be fixed by our Board of Directors or an authorized committee. Subject to applicable fiscal or other laws and regulations, each payment will be made by dollar check drawn on a bank in London or in New York City and mailed to the record holder at the holder's address as it appears on the register for the preference shares. If any date on which dividends are payable on the preference shares is not a "business day," which is a day on which banks are open for business and on which foreign exchange dealings may be conducted in London and in New York City, then payment of the dividend payable on that date will be made on the next business day. There will be no additional interest or other payment due to this type of delay.

Dividends on the preference shares of any series will be non-cumulative. If a dividend on a series is not paid, or is paid only in part, the holders of preference shares of the relevant series will have no claim in respect of such unpaid amount. We will have no obligation to pay the dividend accrued for the relevant dividend period or to pay any interest on the dividend, whether or not dividends on the preference shares of that series or any other series or class of our shares are paid for any subsequent dividend period.

No full dividends will be paid or set apart for payment on the preference shares of any series on a dividend payment date unless full dividends have been, or at the same time are, paid, or set aside for payment, on any preference shares or other class of shares ranking as to dividends in priority or equally with the preference shares and either (a) payable on that dividend payment date or (b) payable before such dividend payment date, but only if such preference shares or other class of shares carry cumulative dividend payment rights.

Except as provided in the preceding sentence, unless full dividends on all outstanding preference shares of a series have been paid for the most recently completed dividend period, no dividends will be declared or paid or set apart for payment, or other distribution made, upon our ordinary shares or other shares ranking, as to dividends or upon liquidation, equally with or below the preference shares of the series (other than a final dividend declared by Barclays PLC and paid by it to shareholders prior to the relevant dividend payment date and/or a dividend paid by Barclays Bank PLC to Barclays PLC or to another wholly owned subsidiary). In addition, we will not redeem, repurchase or otherwise acquire for consideration, or pay any money or make any money available for a sinking fund for the redemption of, any of our ordinary shares or other shares ranking equally with or below the preference shares of the series as to dividends or upon liquidation, except by conversion into, or exchange for, shares ranking below the preference shares of the series as to dividends and upon liquidation, until the earlier of (a) our resumption of payment of full dividends for four consecutive quarterly dividend periods on all outstanding preference shares of the series and (b) the date on or by which all outstanding preference shares of that series have either been redeemed in full or been purchased by or for the account of Barclays Bank PLC.

We will compute the amount of dividends payable on the preference shares of any series for each dividend period based upon the liquidation value per share of the preference shares of the series by annualizing the applicable dividend rate and dividing by the number of dividend periods in a year. However, we will compute the amount of dividends payable for any dividend period shorter than a full dividend period (a) in respect of any fixed rate dividend period, on the basis of a 360-day year divided into twelve months of 30 days each and, in the case of an incomplete month, on the basis of the actual number of days elapsed, and (b) in respect of any floating rate dividend period, on the basis of the number of days in the period divided by 360.

For the avoidance of doubt, unless the relevant prospectus supplement provides otherwise, any amounts to be paid by us on the preference shares will be paid net of any deduction or withholding imposed or required pursuant to Sections 1471 through 1474 of the Code, any current or future regulations or official interpretations thereof, any agreement entered into pursuant to Section 1471(b) of the Code, or any FATCA Withholding Tax, and we will not be required to pay Additional Amounts on account of any FATCA Withholding Tax.

Rights Upon Liquidation

If there is a return of capital in respect of our voluntary or involuntary liquidation, dissolution, winding-up or otherwise, other than in respect of any redemption or repurchase of the preference shares of a series in whole or in part permitted by our Articles of Association and under applicable law, the holders of the outstanding preference shares of a series will be entitled to receive liquidating distributions. Liquidating distributions will:

- come from the assets we have available for distribution to shareholders, before any distribution of assets is made to holders of our ordinary shares or any other class of shares ranking below the preference shares upon a return of capital; and

- be in an amount equal to the liquidation value per share of the preference shares, plus an amount equal to accrued and unpaid dividends, whether or not declared or earned, for the then-current dividend period up to and including the date of commencement of our winding-up or the date of any other return of capital, as the case may be.

If, upon a return of capital, the assets available for distribution are insufficient to pay in full the amounts payable on the preference shares and any other of our shares ranking as to any distribution equally with the preference shares, the holders of the preference shares and of the other shares will share pro rata in any distribution of our assets in proportion to the full respective liquidating distributions to which they are entitled. After payment of the full amount of the liquidating distribution to which they are entitled, the holders of the preference shares of that series will have no claim on any of our remaining assets and will not be entitled to any further participation in the return of capital. If there is a sale of all or substantially all of our assets, the distribution to our shareholders of all or substantially all of the consideration for the sale, unless the consideration, apart from assumption of liabilities, or the net proceeds consists entirely of cash, will not be deemed a return of capital in respect of our liquidation, dissolution or winding-up.

Redemption

Unless the relevant prospectus supplement specifies otherwise, we may redeem the preference shares of each series, at our option, in whole or in part, at any time and from time to time on the dates and at the redemption prices and on all other terms and conditions as set forth in the applicable prospectus supplement. Preference shares comprising preference share units will be redeemed only as units.

If fewer than all of the outstanding preference shares of a series are to be redeemed, we will select by lot, in the presence of our independent auditors, which particular preference shares will be redeemed.

If we redeem preference shares of a series, we will mail a redemption notice to each record holder of preference shares to be redeemed between 30 and 60 days before the redemption date. Each redemption notice will specify:

- the redemption date;

- the particular preference shares of the series to be redeemed;

- the redemption price, specifying the included amount of accrued and unpaid dividends;

- that any dividends will cease to accrue upon the redemption of the preference shares; and

- the place or places where holders may surrender documents of title and obtain payment of the redemption price.

No defect in the redemption notice or in the giving of notice will affect the validity of the redemption proceedings.

If we give notice of redemption in respect of the preference shares of a series, then, by 12:00 noon, London time, on the redemption date, we will irrevocably deposit with the paying agent funds sufficient to pay the applicable

redemption price, including the amount of accrued and unpaid dividends (if any) for the then-current quarterly dividend period to the date fixed for redemption. We will also give the paying agent irrevocable instructions and authority to pay the redemption price to the holders of those preference shares called for redemption.

If we give notice of redemption, then, when we make the deposit with the paying agent, all rights of holders of the preference shares of the series called for redemption will cease, except the holders' right to receive the redemption price, but without interest, and these preference shares will no longer be outstanding. Subject to any applicable fiscal or other laws and regulations, payments in respect of the redemption of preference shares of a series will be made by dollar check drawn on a bank in London or in New York City against presentation and surrender of the relevant share certificates at the office of the paying agent located in the United Kingdom.

In the event that any date on which a redemption payment on the preference shares is to be made is not a business day, then payment of the redemption price payable on that date will be made on the next business day. There will be no interest or other payment due to the delay. If payment of the redemption price is improperly withheld or refused, dividends on the preference shares will continue to accrue at the then applicable rate, from the redemption date to the date of payment of the redemption price.

Subject to applicable law, including U.S. securities laws, and the prior notification of the PRA, we may purchase outstanding preference shares of any series by tender, in the open market or by private agreement. Unless we tell you otherwise in the applicable prospectus supplement, any preference shares of any series that we purchase for our own account, other than in the ordinary course of a business of dealing in securities, will be treated as canceled and will no longer be issued and outstanding.

Under the current practices of the PRA, we may not redeem any preference shares following the fifth anniversary of their date of issue unless we have given the PRA notice in writing (in the form required by the PRA) of the redemption of the preference shares at least one month before becoming committed to the redemption and have provided the PRA with certain information in connection with such repayment as required by the PRA's General Prudential Sourcebook.

Voting Rights

The holders of the preference shares of any series will not be entitled to receive notice of, attend or vote at any general meeting of our shareholders except as provided below or in the applicable prospectus supplement.

Variation of Rights

If applicable law permits, the rights, preferences and privileges attached to any series of preference shares may be varied or abrogated only with the written consent of the holders of at least three-quarters of the outstanding preference shares of the series or with the sanction of a special resolution passed at a separate general meeting of the holders of the outstanding preference shares of the series. A special resolution will be adopted if passed by a majority of at least three-quarters of those holders voting in person or by proxy at the meeting. The quorum required for this separate general meeting will be persons holding or representing by proxy at least one-third of the outstanding preference shares of the affected series, except that if at any adjourned meeting where this quorum requirement is not met, any two holders present in person or by proxy will constitute a quorum.

In addition to the voting rights referred to above, if any resolution is proposed for our liquidation, dissolution or winding-up, then the holders of the outstanding preference shares of each series, other than any series of preference shares which do not have voting rights, will be entitled to receive notice of and to attend the general meeting of shareholders called for the purpose of adopting the resolution and will be entitled to vote on that resolution, but no other. When entitled to vote, each holder of preference shares of a series present in person or by proxy has one vote for each preference share held.

Notices of Meetings

A notice of any meeting at which holders of preference shares of a particular series are entitled to vote will be mailed to each record holder of preference shares of that series. Each notice will state:

- the date of the meeting;
- a description of any resolution to be proposed for adoption at the meeting on which those holders are entitled to vote; and
- instructions for the delivery of proxies.

A holder of preference shares of any series in registered form who is not registered with an address in the United Kingdom and who has not supplied an address within the United Kingdom to us for the purpose of notices is not entitled to receive notices of meetings from us. For a description of notices that we will give to the ADR depositary and that the ADR depositary will give to ADR holders, you should read "Description of American Depositary Receipts—Reports and Notices" and "Where You Can Find More Information."

Registrar and Paying Agent

Our registrar, presently located at One Canada Square, London E14 5AL, United Kingdom, will act as registrar and paying agent for the preference shares of each series.

DESCRIPTION OF AMERICAN DEPOSITARY SHARES

The following is a summary of the general terms and provisions of the deposit agreement under which the ADR depositary will issue the ADRs evidencing ADSs that may represent preference shares. The deposit agreement is among us, The Bank of New York Mellon, as ADR depositary, and all holders from time to time of ADRs issued under the deposit agreement. This summary does not purport to be complete. We may amend or supersede all or part of this summary to the extent we tell you in the applicable prospectus supplement. You should read the deposit agreement, which is filed with the SEC as an exhibit to the registration statement, of which this prospectus is a part. You may also read the deposit agreement at the corporate trust office of The Bank of New York Mellon in New York City and the office of The Bank of New York Mellon in London.

Depositary

The Bank of New York Mellon will act as the ADR depositary. The office of The Bank of New York Mellon in London will act as custodian. The ADR depositary's principal office in New York City is presently located at 101 Barclay Street, Floor 21 West, New York, New York 10286, and the custodian's office is presently located at One Canada Square, London E14 5AL, United Kingdom.

American Depositary Receipts

An ADR is a certificate evidencing a specific number of ADSs of a specific series, each of which will represent preference shares of a corresponding series. Unless the relevant prospectus supplement specifies otherwise, each ADS will represent one preference share, or evidence of rights to receive one preference share, deposited with the London branch of The Bank of New York Mellon, as custodian. An ADR may evidence any number of ADSs in the corresponding series.

Deposit and Issuance of ADRs

When the custodian has received preference shares of a particular series, or evidence of rights to receive preference shares, and applicable fees, charges and taxes, subject to the deposit agreement's terms, the ADR depositary will execute and deliver at its corporate trust office in New York City to the person(s) specified by us in writing, an ADR or ADRs registered in the name of such person(s) evidencing the number of ADSs of that series corresponding to the preference shares of that series.

When the ADR depositary has received preference shares of a particular series, or evidence of rights to receive preference shares, and applicable fees, charges and taxes, subject to the deposit agreement's terms, the ADR depositary will execute and deliver at its principal office to the person(s) specified by us in writing, an ADR or ADRs registered in the name of that person(s) evidencing the number of ADSs of that series corresponding to the preference shares of that series. Preference shares may be deposited under the deposit agreement as units comprising a preference share of a series and a preference share of a related series.

Withdrawal of Deposited Securities

Upon surrender of ADRs at the ADR depositary's corporate trust office in New York City and upon payment of the taxes, charges and fees provided in the deposit agreement and subject to its terms, an ADR holder is entitled to delivery, to or upon its order, at the ADR depositary's corporate trust office in New York City or the custodian's office in London, of the amount of preference shares of the relevant series represented by the ADSs evidenced by the surrendered ADRs. The ADR holder will bear the risk and expense for the forwarding of share certificates and other documents of title to the corporate trust office of the ADR depositary.

Holders of preference shares that have been withdrawn from deposit under the deposit agreement will not have the right to redeposit the preference shares.

Dividends and Other Distributions

The ADR depositary will distribute all cash dividends or other cash distributions that it receives in respect of deposited preference shares of a particular series to ADR holders, after payment of any charges and fees provided for in the deposit agreement, in proportion to their holdings of ADSs of the series representing the preference shares. The cash amount distributed will be reduced by any amounts that we or the ADR depositary must withhold on account of taxes.

If we make a non-cash distribution in respect of any deposited preference shares of a particular series, the ADR depositary will distribute the property it receives to ADR holders, after deduction or upon payment of any taxes, charges and fees provided for in the deposit agreement, in proportion to their holdings of ADSs of the series representing the preference shares. If a distribution that we make in respect of deposited preference shares of a particular series consists of a dividend in, or free distribution of, preference shares of that series, the ADR depositary may, if we approve, and will, if we request, distribute to ADR holders, in proportion to their holdings of ADSs of the relevant series, additional ADRs evidencing an aggregate number of ADSs of that series representing the amount of preference shares received as such dividend or free distribution. If the ADR depositary does not distribute additional ADRs, each ADS of that series will from then forward also represent the additional preference shares of the corresponding series distributed in respect of the deposited preference shares before the dividend or free distribution.

If the ADR depositary determines that any distribution of property, other than cash or preference shares of a particular series, cannot be made proportionately among ADR holders or, if for any other reason, including any requirement that we or the ADR depositary withhold an amount on account of taxes or other governmental charges, the ADR depositary deems that such a distribution is not feasible, the ADR depositary may dispose of all or part of the property in any manner, including by public or private sale, that it deems equitable and practicable. The ADR depositary will then distribute the net proceeds of any such sale (net of any fees and expenses of the ADR depositary provided for in the deposit agreement) to ADR holders as in the case of a distribution received in cash.

For the avoidance of doubt, unless the relevant prospectus supplement provides otherwise, any amounts to be paid by us on the ADSs will be paid net of any deduction or withholding imposed or required pursuant to Sections 1471 through 1474 of the Code, any current or future regulations or official interpretations thereof, any agreement entered into pursuant to Section 1471(b) of the Code, or any FATCA Withholding Tax, and we will not be required to pay Additional Amounts on account of any FATCA Withholding Tax.

Redemption of ADSs

If we redeem any preference shares of a particular series that are represented by ADSs, the ADR depositary will redeem, from the amounts that it receives from the redemption of deposited preference shares of that series, the relevant number of ADSs of the series representing those preference shares that corresponds to the number of deposited preference shares of that series. The ADS redemption price will correspond to the redemption price per preference share payable with respect to the redeemed preference shares. If we do not redeem all of the outstanding preference shares of a particular series, the ADR depositary will select the ADSs of the corresponding series to be redeemed, either by lot or pro rata to the number of preference shares represented.

We must give notice of redemption in respect of the preference shares of a particular series that are represented by ADSs to the ADR depositary not less than 30 days before the redemption date. The ADR depositary will promptly deliver the notice to all holders of ADRs of the corresponding series.

Record Date

Whenever any dividend or other distribution becomes payable or shall be made in respect of preference shares of a particular series, or any preference shares of a particular series are to be redeemed, or the ADR depositary receives notice of any meeting at which holders of preference shares of a particular series are entitled to vote, the ADR depositary will fix a record date for the determination of the ADR holders who are entitled to receive the dividend, distribution, amount in respect of redemption of ADSs of the corresponding series, or the net proceeds of their sale,

or, as applicable, give instructions for the exercise of voting rights at the meeting, subject to the provisions of the deposit agreement. This record date will be as near as practicable to the corresponding record date for the underlying preference share.

Voting of the Underlying Deposited Securities

When the ADR depositary receives notice of any meeting or solicitation of consents or proxies of holders of preference shares of a particular series, it will, at our written request and as soon as practicable thereafter, mail to the record holders of ADRs a notice including:

- the information contained in the notice of meeting;
- a statement that the record holders of ADRs at the close of business on a specified record date will be entitled, subject to any applicable provision of English law, to instruct the ADR depositary as to the exercise of any voting rights pertaining to the preference shares of the series represented by their ADSs; and
- a brief explanation of how they may give instructions, including an express indication that they may instruct the ADR depositary to give a discretionary proxy to designated member or members of our board of directors if no such instruction is received.

The ADR depositary has agreed that it will endeavor, insofar as practical, to vote or cause to be voted the preference shares in accordance with any written non-discretionary instructions of record holders of ADRs that it receives on or before the record date set by the ADR depositary. The ADR depositary will not vote the preference shares except in accordance with such instructions or deemed instructions.

If the ADR depositary does not receive instructions from any ADR holder on or before the date the ADR depositary establishes for this purpose, the ADR depositary will deem such holder to have directed the ADR depositary to give a discretionary proxy to a designated member or members of our board of directors. However, the ADR depositary will not give a discretionary proxy to a designated member or members of our board of directors with respect to any matter as to which we inform the ADR depositary that:

- we do not wish the proxy to be given;
- substantial opposition exists; or
- the rights of holders of the preference shares may be materially affected.

Holders of ADRs evidencing ADSs will not be entitled to vote shares of the corresponding series of preference shares directly.

Inspection of Transfer Books

The ADR depositary will, at its corporate trust office in New York City, keep books for the registration and transfer of ADRs. These books will be open for inspection by ADR holders at all reasonable times. However, this inspection may not be for the purpose of communicating with ADR holders in the interest of a business or object other than our business or a matter related to the deposit agreement or the ADRs.

Reports and Notices

We will furnish the ADR depositary with our annual reports as described under “Where You Can Find More Information” in this prospectus. The ADR depositary will make available at its corporate trust office in New York City, for any ADR holder to inspect, any reports and communications received from us that are both received by the ADR depositary as holder of preference shares and made generally available by us to the holders of those preference

shares. This includes our annual report and accounts. Upon written request, the ADR depositary will mail copies of those reports to ADR holders as provided in the deposit agreement.

On or before the first date on which we give notice, by publication or otherwise, of:

- any meeting of holders of preference shares of a particular series;
- any adjourned meeting of holders of preference shares of a particular series; or
- the taking of any action in respect of any cash or other distributions, or the offering of any rights, in respect of preference shares of a particular series

we have agreed to transmit to the ADR depositary and the custodian a copy of the notice in the form given or to be given to holders of the preference shares. If requested in writing by us, the ADR depositary will, at our expense, arrange for the prompt transmittal or mailing of such notices, and any other reports or communications made generally available to holders of the preference shares, to all holders of ADRs evidencing ADSs of the corresponding series.

Amendment and Termination of the Deposit Agreement

The form of the ADRs evidencing ADSs of a particular series and any provisions of the deposit agreement relating to those ADRs may at any time and from time to time be amended by agreement between us and the ADR depositary, without the consent of holders of ADRs, in any respect which we may deem necessary or advisable. Any amendment that imposes or increases any fees or charges, other than taxes and other governmental charges, registration fees, transmission costs, delivery costs or other such expenses, or that otherwise prejudices any substantial existing right of holders of outstanding ADRs evidencing ADSs of a particular series, will not take effect as to any ADRs until 30 days after notice of the amendment has been given to the record holders of those ADRs. Every holder of any ADR at the time an amendment becomes effective, if it has been given notice, will be deemed by continuing to hold the ADR to consent and agree to the amendment and to be bound by the deposit agreement or the ADR as amended. No amendment may impair the right of any holder of ADRs to surrender ADRs and receive in return the preference shares of the corresponding series represented by the ADSs.

Whenever we direct, the ADR depositary has agreed to terminate the deposit agreement as to ADRs evidencing ADSs of a particular series by mailing a termination notice to the record holders of all ADRs then outstanding at least 30 days before the date fixed in the notice of termination. The ADR depositary may likewise terminate the deposit agreement as to ADRs evidencing ADSs of a particular series by mailing a termination notice to us and the record holders of all ADRs then outstanding if at any time 90 days shall have expired since the ADR depositary delivered a written notice to us of its election to resign and a successor ADR depositary shall not have been appointed and accepted its appointment.

If any ADRs evidencing ADSs of a particular series remain outstanding after the date of any termination, the ADR depositary will then:

- discontinue the registration of transfers of those ADRs;
- suspend the distribution of dividends to holders of those ADRs; and
- not give any further notices or perform any further acts under the deposit agreement, except those listed below, with respect to those ADRs.

The ADR depositary will, however, continue to collect dividends and other distributions pertaining to the preference shares of the corresponding series. It will also continue to sell rights and other property as provided in the deposit agreement and deliver preference shares of the corresponding series, together with any dividends or other distributions received with respect to them and the net proceeds of the sale of any rights or other property, in exchange for ADRs surrendered to it.

At any time after the expiration of one year from the date of termination of the deposit agreement as to ADRs evidencing ADSs of a particular series, the ADR depositary may sell the preference shares of the corresponding series then held. The ADR depositary will then hold uninvested the net proceeds of any such sales, together with any other cash then held by it under the deposit agreement in respect of those ADRs, unsegregated and without liability for interest, for the pro rata benefit of the holders of ADRs that have not previously been surrendered.

Charges of ADR Depositary

Unless the applicable prospectus supplement specifies otherwise, the ADR depositary will charge the party to whom it delivers ADRs against deposits, and the party surrendering ADRs for delivery of preference shares of a particular series or other deposited securities, property and cash, $5.00 for each 100, or fraction of 100, ADSs evidenced by the ADRs issued or surrendered. We will pay all other charges of the ADR depositary and those of any registrar, co-transfer agent and co-registrar under the deposit agreement, but unless the applicable prospectus supplement specifies otherwise, we will not pay:

- taxes, including issue or transfer taxes, U.K. stamp duty or U.K. stamp duty reserve tax other than that payable on the issue of preference shares to the custodian, and other governmental charges;
- any applicable share transfer or registration fees on deposits or withdrawals of preference shares;
- cable, telex, facsimile transmission and delivery charges which the deposit agreement provides are at the expense of the holders of ADRs or persons depositing or withdrawing preference shares of any series; or
- expenses incurred or paid by the ADR depositary in conversion of foreign currency into U.S. dollars.

You will be responsible for any taxes or other governmental charges payable on your ADRs or on the preference shares underlying your ADRs. The ADR depositary may refuse to transfer your ADRs or allow you to withdraw the preference shares underlying your ADRs until such taxes or other charges are paid. It may apply payments owed to you or sell deposited preference shares underlying your ADRs to pay any taxes owed and you will remain liable for any deficiency. If the ADR depositary sells deposited preference shares, it will, if appropriate, reduce the number of ADSs to reflect the sale and pay to you any proceeds, or send to you any property, remaining after it has paid the taxes.

General

Neither the ADR depositary nor we will be liable to ADR holders if prevented or forbidden or delayed by any present or future law of any country or by any governmental authority, any present or future provision of our articles of association or of the preference shares, or any act of God or war or other circumstances beyond our control in performing our obligations under the deposit agreement. The obligations of us both under the deposit agreement are expressly limited to performing our duties without gross negligence or bad faith.

If any ADSs of a particular series are listed on one or more stock exchanges in the U.S., the ADR depositary will act as registrar or, at our request or with our approval, appoint a registrar or one or more co-registrars for registration of the ADRs evidencing the ADSs in accordance with any exchange requirements. The ADR depositary may remove the registrars or co-registrars and appoint a substitute(s) if we request it or with our approval.

The ADRs evidencing ADSs of any series are transferable on the books of the ADR depositary or its agent. However, the ADR depositary may close the transfer books as to ADRs evidencing ADSs of a particular series at any time when it deems it expedient to do so in connection with the performance of its duties or at our request. As a condition precedent to the execution and delivery, registration of transfer, split-up, combination or surrender of any ADR or withdrawal of any preference shares of the corresponding series, the ADR depositary or the custodian may require the person presenting the ADR or depositing the preference shares to pay a sum sufficient to reimburse it for any related tax or other governmental charge and any share transfer or registration fee and any applicable fees payable as provided in the deposit agreement. The ADR depositary may withhold any dividends or other distributions, or may sell for the account of the holder any part or all of the preference shares evidenced by the ADR,

and may apply those dividends or other distributions or the proceeds of any sale in payment of the tax or other governmental charge. The ADR holder will remain liable for any deficiency.

Any ADR holder may be required from time to time to furnish the ADR depositary or the custodian with proof satisfactory to the ADR depositary of citizenship or residence, exchange control approval, information relating to the registration on our books or those that the registrar maintains for us for the preference shares in registered form of that series, or other information, to execute certificates and to make representations and warranties that the ADR depositary deems necessary or proper. Until those requirements have been satisfied, the ADR depositary may withhold the delivery or registration of transfer of any ADR or the distribution or sale of any dividend or other distribution or proceeds of any sale or distribution or the delivery of any deposited preference shares or other property related to the ADR. The delivery, transfer and surrender of ADRs of any series may be suspended during any period when the transfer books of the ADR depositary are closed or if we or the ADR depositary deem it necessary or advisable.

The deposit agreement and the ADRs are governed by and construed in accordance with the laws of the State of New York.

DESCRIPTION OF SHARE CAPITAL

The following is a summary of general information about our share capital and some provisions of our Articles of Association. This summary does not purport to be complete. It is subject to, and qualified by reference to, our Articles of Association, which you should read. We have included a copy of our Articles of Association with the SEC as an exhibit to the registration statement of which this prospectus forms a part.

General

As of March 31, 2016, 2,342,558,515 ordinary shares of £1 each were in issue (all of which were beneficially held by Barclays PLC); 237,000,000 dollar-denominated preference shares of $0.25 each; 58,133 dollar-denominated preference shares of $100 each; 31,856 euro-denominated preference shares of €100 each; 1,000 sterling-denominated preference shares of £1 each (all of which were beneficially held by Barclays PLC); and 20,930 sterling-denominated preference shares of £100 each, all of which have been issued.

Ordinary Shares

Dividend Rights

Holders of ordinary shares are entitled to receive, according to the amounts paid up on the shares and apportioned and paid proportionately to the amount paid up on the shares, any dividends that we may declare at a general meeting of shareholders, but no dividends are payable in excess of the amount that our Board of Directors recommends. The Board of Directors may declare and pay to the holders of ordinary shares interim dividends if, in the opinion of our Board, our distributable reserves justify such payment.

Dividends on ordinary shares, as well as on dollar-denominated preference shares of any series, may only be declared and paid out of our "distributable profits." Rules prescribed by the U.K. Companies Act 2006 (the "Companies Act") determine how much of our funds represent distributable profits. In broad outline, dividend distributions may only be made out of accumulated realized profits, so far as not previously utilized by distribution or capitalization, less its accumulated, realized losses, so far as not previously written off in a reduction or reorganization of capital duly made.

So long as dollar-denominated preference shares of any series are outstanding and full dividends on them have not been paid (or a sum has not been set aside in full) for any dividend period, no interim dividends may be declared or paid, or other distribution made, upon our ordinary shares. We may, however, pay dividends on our ordinary shares or other shares ranking below the dollar-denominated preference shares of those series as to dividends upon liquidation. In addition, we may not redeem, repurchase or otherwise acquire for any consideration, or pay or make any moneys available for a sinking fund for the redemption of these shares, except by conversion into or exchange for our shares ranking below the dollar-denominated preference shares as to dividends and upon liquidation, until we have resumed the payment of full dividends (or a sum set aside in full) on all outstanding dollar-denominated preference shares or redeem the relevant preference shares in full.

Rights upon Liquidation

If there is a return of capital on our winding-up or otherwise, after payment of all liabilities, and after paying or setting apart for payment the full preferential amounts to which the holders of all outstanding dollar-denominated preference shares of any series and any other of our shares ranking senior to the ordinary shares upon liquidation are entitled, our remaining assets will be divided among the holders of ordinary shares pro rata according to the number of ordinary shares held by them.

Voting Rights

Every holder present (not being present by proxy) and entitled to vote on the resolution has one vote on a show of hands. Every proxy present who has been appointed by just one holder entitled to vote on the resolution has one vote on a show of hands, while every proxy who has been appointed by more than one holder entitled to vote on the

resolution has one vote for each way directed by the holders, that is one vote affirming the resolution (if one or more holders direct or have granted the proxy discretion in how to vote) and one vote opposing the resolution (if one or more holders direct or have granted the proxy discretion in how to vote). On a poll, every holder present in person or by proxy and entitled to vote has one vote in respect of each £1 nominal capital held by the relevant holder. Voting at any general meeting of shareholders is by show of hands unless a poll is demanded. A poll may be demanded by the chairman of the meeting or by any shareholder present in person or by proxy and entitled to vote.

Miscellaneous

Holders of ordinary shares and dollar-denominated preference shares have no pre-emptive rights under our Articles of Association. However, except in some cases, English law restricts the ability of our Board of Directors, without appropriate authorization from the holders of our ordinary shares at a general meeting, to:

- allot any shares or rights to subscribe for, or to convert any security into, any of our shares; or
- issue for cash ordinary shares or rights to subscribe for, or to convert any security into, ordinary shares other than through rights to existing holders of ordinary shares.

TAX CONSIDERATIONS

U.S. Taxation

This section describes the material U.S. federal income tax consequences of owning preference shares, ADSs or debt securities. It is the opinion of Sullivan & Cromwell LLP, our U.S. tax counsel. It applies to you only if you hold your preference shares, ADSs or debt securities as capital assets for U.S. federal income tax purposes. The U.S. federal income tax consequences of owning warrants will be described in the applicable pricing supplement.

This section does not apply to you if you are a member of a class of holders subject to special rules, including:

- a dealer in securities;
- a trader in securities that elects to use a mark-to-market method of accounting for your securities holdings;
- a tax-exempt organization;
- a life insurance company;
- a person that holds preference shares, ADSs or debt securities as part of a straddle or a hedging or conversion transaction for tax purposes;
- a person that purchases or sells preference shares, ADSs or debt securities as part of a wash sale for tax purposes;
- a U.S. holder (as defined below) whose functional currency for tax purposes is not the U.S. dollar;
- a bank;
- a person liable for alternative minimum tax; or
- a person that actually or constructively owns 10% or more of our voting stock.

This section is based on the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations, published rulings and court decisions, as well as on the income tax convention between the United States of America and the United Kingdom (the "Treaty"). These laws are subject to change, possibly on a retroactive basis. In addition, this section is based in part upon the representations of the ADR depositary. Assuming that each obligation in the deposit agreement and any related agreement will be performed in accordance with its terms, for U.S. federal income tax purposes, if you hold ADRs evidencing ADSs, you will in general be treated as the owner of the preference shares represented by those ADSs. Exchanges of preference shares for ADSs or ADSs for preference shares generally will not be subject to U.S. federal income tax.

If an entity or arrangement treated as a partnership for U.S. federal income tax purposes holds the preference shares, ADSs or debt securities, the U.S. federal income tax treatment of a partner will generally depend on the status of the partner and the tax treatment of the partnership. A partner in an entity or arrangement treated as a partnership for U.S. federal income tax purposes holding the preference shares, ADSs or debt securities should consult its tax advisor with regard to the U.S. federal income tax treatment of an investment in the preference shares, ADSs or debt securities.

You should consult your own tax advisor regarding the U.S. federal, state and local and other tax consequences of owning and disposing of preference shares, ADSs or debt securities in your particular circumstances.

U.S. Holders

This subsection describes the material U.S. federal income tax consequences to a U.S. holder of owning preference shares, ADSs or debt securities. You are a U.S. holder if you are a beneficial owner of preference shares, ADSs or debt securities and you are, for U.S. federal income tax purposes:

- a citizen or resident of the United States;
- a domestic corporation;
- an estate whose income is subject to U.S. federal income tax regardless of its source; or
- a trust if a U.S. court can exercise primary supervision over the trust's administration and one or more U.S. persons are authorized to control all substantial decisions of the trust.

If you are not a U.S. holder, this subsection does not apply to you, and you should refer to "—Taxation of U.S. Alien Holders" below.

Taxation of Debt Securities

This subsection deals only with debt securities denominated in U.S. dollars that are due to mature 30 years or less from the date on which they are issued. The U.S. federal income tax consequences of owning debt securities that are denominated in a currency other than the U.S. dollar (or the payments that are determined by reference to a currency other than the U.S. dollar) as well as the U.S. federal income tax consequences of owning debt securities that are due to mature more than 30 years from their date of issue will be discussed in an applicable prospectus supplement. In addition, this subsection does not address the U.S. federal income tax consequences of owning convertible or exchangeable debt securities; the U.S. federal income tax consequences of owning convertible or exchangeable debt securities will be addressed in the applicable prospectus supplement. This subsection also does not address the U.S. federal income tax consequences of owning bearer debt securities. U.S. holders of certain bearer debt securities may be subject to additional, adverse U.S. federal income tax rules. Dated Subordinated Debt Securities may be subject to additional U.S. federal income tax rules which will be discussed in the relevant pricing supplement.

Payments of Interest

Except as described below in the case of interest on a "discount debt security" that is not "qualified stated interest", each as defined below under "—Original Issue Discount—General," you will be taxed on any interest on your debt securities as ordinary income at the time you receive the interest or when it accrues, depending on your method of accounting for tax purposes.

Interest paid by us on the debt securities and original issue discount, or OID, if any, accrued with respect to the debt securities (as described below under "Original Issue Discount") and any additional amounts paid with respect to withholding tax on the debt securities, including withholding tax on payments of such additional amounts ("additional amounts"), is income from sources outside the United States and will, depending on your circumstances, be either "passive" or "general" income for purposes of computing the foreign tax credit.

Original Issue Discount

General. If you own a debt security, other than a short-term debt security with a term of one year or less, it will be treated as a discount debt security issued with OID if the amount by which the debt security's stated redemption price at maturity exceeds its issue price is more than a de minimis amount. Generally, a debt security's issue price will be the first price at which a substantial amount of debt securities included in the issue of which the debt security is a part is sold to persons other than bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers. A debt security's stated redemption price at maturity is the total of all payments provided by the debt security that are not payments of qualified stated interest. Generally, an interest payment on a debt security is qualified stated interest if it is one of a series of stated interest payments on a debt

security that are unconditionally payable at least annually at a single fixed rate, with certain exceptions for lower rates paid during some periods, applied to the outstanding principal amount of the debt security. There are special rules for variable rate debt securities that are discussed under "—Variable Rate Debt Securities."

In general, your debt security is not a discount debt security if the amount by which its stated redemption price at maturity exceeds its issue price is less than the de minimis amount of 1/4 of 1% of its stated redemption price at maturity multiplied by the number of complete years to its maturity. Your debt security will have de minimis OID if the amount of the excess is less than the de minimis amount. If your debt security has de minimis OID, you must include the de minimis OID in income as stated principal payments are made on the debt security, unless you make the election described below under "—Election to Treat All Interest as Original Issue Discount." You can determine the includible amount with respect to each such payment by multiplying the total amount of your debt security's de minimis OID by a fraction equal to:

- the amount of the principal payment made divided by:
- the stated principal amount of the debt security.

Generally, if your discount debt security matures more than one year from its date of issue, you must include OID in income before you receive cash attributable to that income. The amount of OID that you must include in income is calculated using a constant-yield method, and generally you will include increasingly greater amounts of OID in income over the life of your debt security. More specifically, you can calculate the amount of OID that you must include in income by adding the daily portions of OID with respect to your discount debt security for each day during the taxable year or portion of the taxable year that you hold your discount debt security. You can determine the daily portion by allocating to each day in any accrual period a pro rata portion of the OID allocable to that accrual period. You may select an accrual period of any length with respect to your discount debt security and you may vary the length of each accrual period over the term of your discount debt security. However, no accrual period may be longer than one year and each scheduled payment of interest or principal on the discount debt security must occur on either the first or final day of an accrual period.

You can determine the amount of OID allocable to an accrual period by:

- multiplying your discount debt security's adjusted issue price at the beginning of the accrual period by your debt security's yield to maturity, and then
- subtracting from this figure the sum of the payments of qualified stated interest on your debt security allocable to the accrual period.

You must determine the discount debt security's yield to maturity on the basis of compounding at the close of each accrual period and adjusting for the length of each accrual period. Further, you determine your discount debt security's adjusted issue price at the beginning of any accrual period by:

- adding your discount debt security's issue price and any accrued OID for each prior accrual period; and then
- subtracting any payments previously made on your discount debt security that were not qualified stated interest payments.

If an interval between payments of qualified stated interest on your discount debt security contains more than one accrual period, then, when you determine the amount of OID allocable to an accrual period, you must allocate the amount of qualified stated interest payable at the end of the interval, including any qualified stated interest that is payable on the first day of the accrual period immediately following the interval, pro rata to each accrual period in the interval based on their relative lengths. In addition, you must increase the adjusted issue price at the beginning of each accrual period in the interval by the amount of any qualified stated interest that has accrued prior to the first day of the accrual period but that is not payable until the end of the interval. You may compute the amount of OID

allocable to an initial short accrual period by using any reasonable method if all other accrual periods, other than a final short accrual period, are of equal length.

The amount of OID allocable to the final accrual period is equal to the difference between:

- the amount payable at the maturity of your debt security, other than any payment of qualified stated interest; and

- your debt security's adjusted issue price as of the beginning of the final accrual period.

Acquisition Premium. If you purchase your debt security for an amount that is less than or equal to the sum of all amounts, other than qualified stated interest, payable on your debt security after the purchase date but is greater than the amount of your debt security's adjusted issue price, as determined above under "—General," the excess is acquisition premium. If you do not make the election described below under "—Election to Treat All Interest as Original Issue Discount," then you must reduce the daily portions of OID by a fraction equal to:

- the excess of your adjusted basis in the debt security immediately after purchase over the adjusted issue price of the debt security;

divided by:

- the excess of the sum of all amounts payable, other than qualified stated interest, on the debt security after the purchase date over the debt security's adjusted issue price.

Pre-Issuance Accrued Interest. An election may be made to decrease the issue price of your debt security by the amount of pre-issuance accrued interest if:

- a portion of the initial purchase price of your debt security is attributable to pre-issuance accrued interest;

- the first stated interest payment on your debt security is to be made within one year of your debt security's issue date; and

- the payment will equal or exceed the amount of pre-issuance accrued interest.

If this election is made, a portion of the first stated interest payment will be treated as a return of the excluded pre-issuance accrued interest and not as an amount payable on your debt security.

Debt Securities Subject to Contingencies, Including Optional Redemption. Your debt security is subject to a contingency if it provides for an alternative payment schedule or schedules applicable upon the occurrence of a contingency or contingencies, other than a remote or incidental contingency, whether such contingency relates to payments of interest or of principal. In such a case, you must determine the yield and maturity of your debt security by assuming that the payments will be made according to the payment schedule most likely to occur if:

- the timing and amounts of the payments that comprise each payment schedule are known as of the issue date; and

- one of such schedules is significantly more likely than not to occur.

If there is no single payment schedule that is significantly more likely than not to occur, other than because of a mandatory sinking fund, you must include income on your debt security in accordance with the general rules that govern contingent payment obligations. If applicable, these rules will be discussed in the prospectus supplement.

Notwithstanding the general rules for determining yield and maturity, if your debt security is subject to contingencies, and either you or we have an unconditional option or options that, if exercised, would require payments to be made on the debt security under an alternative payment schedule or schedules, then:

- in the case of an option or options that we may exercise, we will be deemed to exercise or not to exercise an option or a combination of options in the manner that minimizes the yield on your debt security; and,

- in the case of an option or options that you may exercise, you will be deemed to exercise or not to exercise an option or a combination of options in the manner that maximizes the yield on your debt security.

If both you and we hold options described in the preceding sentence, those rules will apply to each option in the order in which they may be exercised. You may determine the yield on your debt security for the purposes of those calculations by using any date on which your debt security may be redeemed or repurchased as the maturity date and the amount payable on the date that you chose in accordance with the terms of your debt security as the principal amount payable at maturity.

If a contingency, including the exercise of an option, actually occurs or does not occur contrary to an assumption made according to the above rules then, except to the extent that a portion of your debt security is repaid as a result of this change in circumstances and solely to determine the amount and accrual of OID, you must redetermine the yield and maturity of your debt security by treating your debt security as having been retired and reissued on the date of the change in circumstances for an amount equal to your debt security's adjusted issue price on that date.

Election to Treat All Interest as Original Issue Discount. You may elect to include in gross income all interest that accrues on your debt security using the constant-yield method described above under "—General," with the modifications described below. For purposes of this election, interest will include stated interest, OID, de minimis OID, market discount, de minimis market discount and unstated interest, as adjusted by any amortizable bond premium, described below under "—Debt Securities Purchased at a Premium," or acquisition premium.

If you make this election for your debt security, then, when you apply the constant-yield method:

- the issue price of your debt security will equal your cost;

- the issue date of your debt security will be the date you acquired it; and

- no payments on your debt security will be treated as payments of qualified stated interest.

Generally, this election will apply only to the debt security for which you make it; however, if the debt security has amortizable bond premium, you will be deemed to have made an election to apply amortizable bond premium against interest for all debt instruments with amortizable bond premium, other than debt instruments the interest on which is excludible from gross income, that you hold as of the beginning of the taxable year to which the election applies or any taxable year thereafter. Additionally, if you make this election for a market discount debt security, you will be treated as having made the election discussed below under "—Market Discount" to include market discount in income currently over the life of all debt instruments having market discount that you acquire on or after the first day of the first taxable year to which the election applies. You may not revoke any election to apply the constant-yield method to all interest on a debt security or the deemed elections with respect to amortizable bond premium or market discount debt securities without the consent of the Internal Revenue Service.

Variable Rate Debt Securities. Your debt security will be a variable rate debt security if:

- your debt security's issue price does not exceed the total noncontingent principal payments by more than the lesser of:

    - 1.5% of the product of the total noncontingent principal payments and the number of complete years to maturity from the issue date; or

    - 15% of the total noncontingent principal payments; and

- your debt security provides for stated interest, compounded or paid at least annually, only at:
    - one or more qualified floating rates;
    - a single fixed rate and one or more qualified floating rates;
    - a single objective rate; or
    - a single fixed rate and a single objective rate that is a qualified inverse floating rate; and

- the value of any floating rate on any date during the term of your debt security is set no earlier than three months prior to the first day on which that value is in effect and no later than one year following that first day.

Your debt security will have a variable rate that is a qualified floating rate if:

- variations in the value of the rate can reasonably be expected to measure contemporaneous variations in the cost of newly borrowed funds in the currency in which your debt security is denominated; or

- the rate is equal to such a rate either:
    - multiplied by a fixed multiple that is greater than 0.65 but not more than 1.35; or
    - multiplied by a fixed multiple that is greater than 0.65 but not more than 1.35, and then increased or decreased by a fixed rate.

If your debt security provides for two or more qualified floating rates that are within 0.25 percentage points of each other on the issue date or can reasonably be expected to have approximately the same values throughout the term of the debt security, the qualified floating rates together constitute a single qualified floating rate.

Your debt security will not have a qualified floating rate, however, if the rate is subject to certain restrictions (including caps, floors, governors, or other similar restrictions) unless such restrictions are fixed throughout the term of the debt security or are not reasonably expected to significantly affect the yield on the debt security.

Your debt security will have a variable rate that is a single objective rate if:

- the rate is not a qualified floating rate; and

- the rate is determined using a single, fixed formula that is based on objective financial or economic information that is not within the control of or unique to the circumstances of the issuer or a related party.

Your debt security will not have a variable rate that is an objective rate, however, if it is reasonably expected that the average value of the rate during the first half of your debt security's term will be either significantly less than or significantly greater than the average value of the rate during the final half of your debt security's term.

An objective rate as described above is a qualified inverse floating rate if:

- the rate is equal to a fixed rate minus a qualified floating rate; and

- the variations in the rate can reasonably be expected to inversely reflect contemporaneous variations in the cost of newly borrowed funds.

Your debt security will also have a single qualified floating rate or an objective rate if interest on your debt security is stated at a fixed rate for an initial period of one year or less followed by either a qualified floating rate or an objective rate for a subsequent period; and either:

- the fixed rate and the qualified floating rate or objective rate have values on the issue date of the debt security that do not differ by more than 0.25 percentage points; or

- the value of the qualified floating rate or objective rate is intended to approximate the fixed rate.

In general, if your variable rate debt security provides for stated interest at a single qualified floating rate or objective rate, or one of those rates after a single fixed rate for an initial period, all stated interest on your debt security is qualified stated interest. In this case, the amount of OID, if any, is determined by using, in the case of a qualified floating rate or qualified inverse floating rate, the value as of the issue date of the qualified floating rate or qualified inverse floating rate, or, for any other objective rate, a fixed rate that reflects the yield reasonably expected for your debt security.

If your variable rate debt security does not provide for stated interest at a single qualified floating rate or a single objective rate, and also does not provide for interest payable at a fixed rate other than a single fixed rate for an initial period, the interest and OID accruals on your debt security are generally determined by:

- determining a fixed rate substitute for each variable rate provided under your variable rate debt security;

- constructing the equivalent fixed rate debt instrument, using the fixed rate substitute described above;

- determining the amount of qualified stated interest and OID with respect to the equivalent fixed rate debt instrument; and

- adjusting for actual variable rates during the applicable accrual period.

The fixed rate substitute for each variable rate provided under the variable rate debt security is generally either the value of each variable rate as of the issue date or, for an objective rate that is not a qualified inverse floating rate, a rate that reflects the reasonably expected yield on your debt security.

If your variable rate debt security provides for stated interest either at one or more qualified floating rates or at a qualified inverse floating rate, and also provides for stated interest at a single fixed rate other than at a single fixed rate for an initial period, the interest and OID accruals are generally determined by using the method described in the previous paragraph. However, your variable rate debt security will be treated, for purposes of the first three steps of the determination, as if your debt security had provided for a qualified floating rate, or a qualified inverse floating rate, rather than the fixed rate. The qualified floating rate, or qualified inverse floating rate, that replaces the fixed rate must be such that the fair market value of your variable rate debt security as of the issue date approximates the fair market value of an otherwise identical debt instrument that provides for the qualified floating rate, or qualified inverse floating rate, rather than the fixed rate.

Short-Term Debt Securities. In general, if you are an individual or other cash basis U.S. holder of a short-term debt security, you are not required to accrue OID, as specially defined below for the purposes of this paragraph, for U.S. federal income tax purposes unless you elect to do so (although it is possible that you may be required to include any stated interest in income as you receive it). If you are an accrual basis taxpayer, a taxpayer in a special class, including, but not limited to, a regulated investment company, common trust fund, or a certain type of pass-through entity, or a cash basis taxpayer who so elects, you will be required to accrue OID on short-term debt securities on either a straight-line basis or under the constant-yield method, based on daily compounding. If you are not required and do not elect to include OID in income currently, any gain you realize on the sale or retirement of your short-term debt security will be ordinary income to the extent of the accrued OID, which will be determined on a straight-line basis unless you make an election to accrue the OID under the constant-yield method, through the date of sale or retirement. However, if you are not required and do not elect to accrue OID on your short-term debt securities, you

will be required to defer deductions for interest on borrowings allocable to your short-term debt securities in an amount not exceeding the deferred income until the deferred income is realized.

When you determine the amount of OID subject to these rules, you must include all interest payments on your short-term debt security, including stated interest, in your short-term debt security's stated redemption price at maturity.

Market Discount

You will be treated as if you purchased your debt security, other than a short-term debt security, at a market discount, and your debt security will be a market discount debt security if:

- you purchase your debt security for less than its issue price as determined above under "Original Issue Discount—General"; and

- the difference between the debt security's stated redemption price at maturity or, in the case of a discount debt security, the debt security's revised issue price, and the price you paid for your debt security is equal to or greater than 1/4 of 1% of your debt security's stated redemption price at maturity or revised issue price, respectively, multiplied by the number of complete years to the debt security's maturity. To determine the revised issue price of your debt security for these purposes, you generally add any OID that has accrued on your debt security to its issue price.

If your debt security's stated redemption price at maturity or, in the case of a discount debt security, its revised issue price, exceeds the price you paid for the debt security by less than 1/4 of 1% multiplied by the number of complete years to the debt security's maturity, the excess constitutes de minimis market discount, and the rules discussed below are not applicable to you.

You must treat any gain you recognize on the maturity or disposition of your market discount debt security as ordinary income to the extent of the accrued market discount on your debt security. Alternatively, you may elect to include market discount in income currently over the life of your debt security. If you make this election, it will apply to all debt instruments with market discount that you acquire on or after the first day of the first taxable year to which the election applies. You may not revoke this election without the consent of the Internal Revenue Service. If you own a market discount debt security and do not make this election, you will generally be required to defer deductions for interest on borrowings allocable to your debt security in an amount not exceeding the accrued market discount on your debt security until the maturity or disposition of your debt security.

You will accrue market discount on your market discount debt security on a straight-line basis unless you elect to accrue market discount using a constant-yield method. If you make this election, it will apply only to the debt security with respect to which it is made and you may not revoke it. You would, however, not include accrued market discount in income unless you elect to do so as described above.

Debt Securities Purchased at a Premium

If you purchase your debt security for an amount in excess of its principal amount (or, in the case of a discount note, in excess of its stated redemption price at maturity), you may elect to treat the excess as amortizable bond premium. If you make this election, you will reduce the amount required to be included in your income each year with respect to interest on your debt security by the amount of amortizable bond premium allocable to that year, based on your debt security's yield to maturity. If you make an election to amortize bond premium, it will apply to all debt instruments, other than debt instruments the interest on which is excludible from gross income, that you hold at the beginning of the first taxable year to which the election applies or that you thereafter acquire, and you may not revoke it without the consent of the Internal Revenue Service. See also "Original Issue Discount—Election to Treat All Interest as Original Issue Discount."

Purchase, Sale and Retirement of the Debt Securities

Your tax basis in your debt security will generally be your cost of your debt security adjusted by:

- adding any OID, de minimis OID, market discount or de minimis market discount previously included in income with respect to your debt security; and then

- subtracting any payments on your debt security that are not qualified stated interest payments and any amortizable bond premium applied to reduce interest on your debt security.

You will generally recognize gain or loss on the sale or retirement of your debt security equal to the difference between the amount you realize on the sale or retirement, excluding any amounts attributable to accrued but unpaid interest (which will be treated as interest payments), and your tax basis in your debt security.

You will recognize capital gain or loss when you sell or retire your debt security, except to the extent:

- described above under "Original Issue Discount—Short-Term Debt Securities" or "Market Discount"; or

- the rules governing contingent payment obligations apply.

Capital gain of a non-corporate U.S. holder is generally taxed at preferential rates where the holder has a holding period of greater than one year. Such gain or loss will generally be income or loss from sources within the United States for foreign tax credit limitation purposes.

Other Debt Securities

The applicable prospectus supplement will discuss any special U.S. federal income tax rules with respect to debt securities the payments on which are determined by reference to any reference asset, debt securities that are denominated in a currency other than the U.S. dollar and other debt securities that are subject to the rules governing contingent payment obligations.

Taxation of Preference Shares and ADSs

Dividends

Under the U.S. federal income tax laws, if you are a U.S. holder, the gross amount of any dividend paid by us out of our current or accumulated earnings and profits (as determined for U.S. federal income tax purposes) is subject to U.S. federal income taxation. Subject to the discussion below under the heading "Passive Foreign Investment Company Considerations," if you are a non-corporate U.S. holder, dividends paid to you that constitute qualified dividend income will be taxable to you at the preferential rates applicable to long-term capital gains provided that you meet certain holding period requirements. Dividends we pay with respect to the preference shares or ADSs generally will be qualified dividend income. The dividend is ordinary income that you must include in income when you, in the case of preference shares, or the ADR depositary, in the case of ADSs, receive the dividend, actually or constructively. The dividend will not be eligible for the dividends-received deduction generally allowed to U.S. corporations in respect of dividends received from other U.S. corporations. Distributions in excess of current and accumulated earnings and profits, as determined for U.S. federal income tax purposes, will be treated as a non-taxable return of capital to the extent of your basis in the preference shares or ADSs and thereafter as capital gain. For foreign tax credit purposes, dividends will generally be income from sources outside the United States and will, depending on your circumstances, be either "passive" or "general" income for purposes of computing the foreign tax credit allowable to you.

Capital Gains

Subject to the discussion below under the heading "Passive Foreign Investment Company Considerations," if you are a U.S. holder and you sell or otherwise dispose of your preference shares or ADSs, you will recognize capital

gain or loss for U.S. federal income tax purposes equal to the difference between the amount that you realize and your tax basis in your preference shares or ADSs. Capital gain of a non-corporate U.S. holder is generally taxed at preferential rates where the holder has a holding period of greater than one year. The gain or loss will generally be income or loss from sources within the United States for foreign tax credit limitation purposes.

Passive Foreign Investment Company Considerations

A non-United States corporation will be a passive foreign investment company (a "PFIC") for any taxable year if either (1) 75% or more of its gross income in the taxable year is passive income or (2) 50% or more of the average value of its assets in the taxable year produces, or is held for the production of, passive income. Based upon certain management estimates and proposed Treasury regulations, Barclays believes that it was not a PFIC for the 2015 taxable year and does not expect that it will be a PFIC in subsequent taxable years. However, since Barclays' status as a PFIC for any taxable year depends on the composition of Barclays' income and assets (and the market value of such assets) from time to time, there can be no assurance that Barclays will not be considered a PFIC for any taxable year. If Barclays were considered a PFIC for any taxable year during which you hold preference shares or ADSs, you could be subject to unfavorable tax consequences, including significantly more tax upon a disposition of such preference shares or ADSs or upon receipt of certain dividends from Barclays. In addition, U.S. persons who own PFIC stock may be required to file an annual information statement with the Internal Revenue Service.

Medicare Tax

A U.S. holder that is an individual or estate, or a trust that does not fall into a special class of trusts that is exempt from such tax, is subject to a 3.8% tax on the lesser of (1) the U.S. holder's "net investment income" (or "undistributed net investment income" in the case of an estate or trust) for the relevant taxable year and (2) the excess of the U.S. holder's modified adjusted gross income for the taxable year over a certain threshold (which in the case of individuals is between $125,000 and $250,000, depending on the individual's circumstances). A holder's net investment income generally includes its interest and dividend income, and its net gains from the disposition of preference shares, ADSs and debt securities, unless such interest or dividend income, or net gains, are derived in the ordinary course of the conduct of a trade or business (other than a trade or business that consists of certain passive or trading activities). If you are a U.S. holder that is an individual, estate or trust, you are urged to consult your tax advisors regarding the applicability of the Medicare tax to your income and gains in respect of your investment in the preference shares, ADSs and debt securities.

U.S. Alien Holders

This subsection describes the tax consequences to a U.S. alien holder of owning and disposing of preference shares, ADSs or debt securities. You are a U.S. alien holder if you are a beneficial owner of a preference share, ADS or debt security and you are, for U.S. federal income tax purposes:

- a non-resident alien individual;
- a foreign corporation; or
- an estate or trust that in either case is not subject to U.S. federal income tax on a net income basis on income or gain from a preference share, ADS or debt security.

If you are a U.S. holder, this subsection does not apply to you.

Interest on Debt Securities and Dividends on Preference Shares or ADSs. If you are a U.S. alien holder, interest paid to you with respect to debt securities and dividends paid to you in respect of your preference shares or ADSs will not be subject to U.S. federal income tax unless the interest or dividends are "effectively connected" with your conduct of a trade or business within the United States (or are treated as such), and, if required by an applicable income tax treaty as a condition for subjecting you to U.S. taxation on a net income basis, the interest or dividends are attributable to a permanent establishment that you maintain in the United States. In such cases you generally will be taxed in the same manner as a U.S. holder. If you are a corporate U.S. alien holder, "effectively connected" interest

or dividends may also, under certain circumstances, be subject to an additional "branch profits tax" at a rate of 30% or at a lower rate if you are eligible for the benefits of an income tax treaty that provides for a lower rate.

Disposition of the Preference Shares, ADSs or Debt Securities. If you are a U.S. alien holder, you generally will not be subject to U.S. federal income tax on gain realized on the sale, exchange or retirement of your preference share, ADS or debt security unless:

- the gain is effectively connected with your conduct of a trade or business in the United States, and the gain is attributable to a permanent establishment that you maintain in the United States if that is required by an applicable income tax treaty as a condition for subjecting you to U.S. taxation on a net income basis; or

- you are an individual, you are present in the United States for 183 or more days during the taxable year in which the gain is realized and certain other conditions exist.

If you are a corporate U.S. alien holder, "effectively connected" gains that you recognize may also, under certain circumstances, be subject to an additional "branch profits tax" at a 30% rate or at a lower rate if you are eligible for the benefits of an income tax treaty that provides for a lower rate.

Information with Respect to Foreign Financial Assets

Owners of "specified foreign financial assets" with an aggregate value in excess of $50,000 (and in some circumstances, a higher threshold) may be required to file an information report with respect to such assets with their tax returns. "Specified foreign financial assets" may include financial accounts maintained by foreign financial institutions, as well as the following, but only if they are held for investment and not held in accounts maintained by financial institutions: (i) stocks and securities issued by non-U.S. persons, (ii) financial instruments and contracts that have non-U.S. issuers or counterparties, and (iii) interests in foreign entities. The preference shares, ADSs and debt securities may be subject to these rules. Holders are urged to consult their tax advisors regarding the application of this reporting requirement to their ownership of the preference shares, ADSs and debt securities.

Foreign Account Tax Compliance Withholding

Certain non-U.S. financial institutions must comply with information reporting requirements or certification requirements in respect of their direct and indirect United States shareholders and/or United States accountholders to avoid becoming subject to withholding on certain payments. Barclays and other non-U.S. financial institutions may accordingly be required to report information to the Internal Revenue Service regarding the holders of preference shares, ADSs and debt securities and to withhold on a portion of payments under the preference shares, ADSs and debt securities to certain holders that fail to comply with the relevant information reporting requirements (or hold the preference shares, ADSs and/or debt securities directly or indirectly through certain non-compliant intermediaries). However, such withholding would generally not apply to payments made before January 1, 2019. Moreover, in the case of debt securities, such withholding would only apply to securities issued at least six months after the date on which final regulations implementing such rule are enacted. Holders are urged to consult their own tax advisors and any banks or brokers through which they will hold preference shares, ADSs and/or debt securities as to the consequences (if any) of these rules to them.

If such withholding is required, Barclays will not be required to pay any additional amounts with respect to any such amounts withheld. Depending on your circumstances, you may be entitled to a refund or credit in respect of some or all of the amounts withheld, but this may entail significant administrative burdens. Holders are urged to consult their tax advisers regarding the application of such withholding tax to their ownership of the preference shares, ADSs or debt securities.

Information Reporting and Backup Withholding

In general, if you are a non-corporate U.S. holder, information reporting requirements, on Internal Revenue Service Form 1099, generally will apply to:

- payments of principal, any premium and interest, and the accrual of OID on a debt security and dividends or other taxable distributions with respect to a preference share or an ADS within the United States; and

- the payment of the proceeds from the sale of a preference share, ADS or debt security effected at a U.S. office of a broker.

Additionally, backup withholding will apply to such payments, including payments of OID, if you are a non-corporate U.S. holder that:

- is notified by the Internal Revenue Service that you have failed to report all interest and dividends required to be shown on your federal income tax returns; or

- in certain circumstances, fails to comply with applicable certification requirements.

If you are a U.S. alien holder, you are generally exempt from backup withholding and information reporting requirements with respect to:

- payments of principal and interest on a debt security or dividends with respect to a preference share or ADS made to you outside the United States by us or another non-U.S. payor; and

- other payments of principal, interest and dividends and the payment of the proceeds from the sale of a preference share, ADS or debt security effected at a U.S. office of a broker, as long as:

    - the payor or broker does not have actual knowledge or reason to know that you are a U.S. person and you have furnished to the payor or broker a valid Internal Revenue Service Form W-8 or other documentation upon which the payor or broker may rely to treat the payments as made to a non-U.S. person; or

- you otherwise establish an exemption.

Payment of the proceeds from the sale of a preference share, ADS or debt security effected at a foreign office of a broker generally will not be subject to information reporting or backup withholding. However, a sale of a preference share, ADS or debt security that is effected at a foreign office of a broker could be subject to backup withholding in the same manner as a sale within the United States (and in certain cases may be subject to backup withholding as well) if:

- the broker has certain connections to the United States;

- the payment of proceeds or the confirmation of the sale is sent to the United States; or

- the sale has some other specified connection with the United States as provided in U.S. Treasury regulations.

You generally may obtain a refund of any amounts withheld under the backup withholding rules that exceed your income tax liability by filing a refund claim with the United States Internal Revenue Service.

United Kingdom Taxation

The following paragraphs summarize certain United Kingdom withholding and other tax considerations with respect to the acquisition, ownership and disposition of the debt securities, preference shares and ADSs described in this prospectus by persons who are the absolute beneficial owners of their debt securities, preference shares or ADSs (as the case may be) and who are neither (a) resident in the United Kingdom for United Kingdom tax purposes nor (b) hold debt securities, preference shares or ADSs in connection with any trade or business carried on in the United Kingdom through any branch, agency or permanent establishment in the United Kingdom. It is based upon the opinion of Clifford Chance LLP, our United Kingdom solicitors. Certain United Kingdom tax considerations with respect to the warrants will be described in the applicable pricing supplement. This summary is based on United Kingdom law and Her Majesty's Revenue & Customs ("HMRC") practice and the provisions of the Double Taxation Treaty between the United Kingdom and the United States (the "Treaty") of July 24, 2001 (as amended) at the date of this prospectus, all of which are subject to change at any time, possibly with retrospective effect.

This summary is not comprehensive and does not deal with the position of United Kingdom resident persons or with that of persons who are resident outside the United Kingdom who carry on a trade, profession or vocation in the United Kingdom through a branch, agency or permanent establishment in the United Kingdom through or for the purposes of which their debt securities, preference shares or ADSs are used or held. Additionally, the summary may not apply to certain classes of persons, such as dealers in securities. The summary below assumes that debt securities will not be issued or transferred to any depositary receipt system and that holders of ADSs will in practice be treated for the purposes of United Kingdom tax as beneficial owners of the preference shares represented by the ADSs.

You should consult your own tax advisors concerning the consequences of acquiring, owning and disposing of debt securities, preference shares and ADSs in your particular circumstances, including the applicability and effect of the Treaty.

Debt Securities

Payments of Interest. If the interest on the debt securities does not have a United Kingdom source, no withholding or deduction for or on account of United Kingdom tax will be made from payments of interest on the debt securities.

Interest on the debt securities may, however, constitute United Kingdom source income for United Kingdom tax purposes. Even if the interest does have a United Kingdom source, debt securities that carry a right to interest will constitute "quoted Eurobonds" within the meaning of Section 987 of the Income Tax Act 2007 (the "ITA"), provided they are and continue to be listed on a "recognised stock exchange" within the meaning of Section 1005 of the ITA. Accordingly, payments of interest (including payments of premium, if any, to the extent such premium, or any part of such premium, constitutes interest for United Kingdom tax purposes) on the debt securities made by us or any paying agent (or received by any collecting agent) may be made (or received, as the case may be) without withholding or deduction for or on account of United Kingdom income tax provided the debt securities are listed on a "recognised stock exchange" at the time the interest is paid.

Interest on the Dated Subordinated Debt Securities may be paid without withholding or deduction for or on account of United Kingdom income tax to the extent that the Dated Subordinated Debt Securities constitute "regulatory capital securities" for the purposes of the Taxation of Regulatory Capital Securities Regulations 2013/3209 (the "2013 Regulations") and there are no arrangements, the main purpose, or one of the main purposes, of which is to obtain a tax advantage as a result of the application of the 2013 Regulations in respect of the Dated Subordinated Debt Securities.

The Dated Subordinated Debt Securities will constitute "regulatory capital securities" for the purposes of the 2013 Regulations provided that they qualify, or have qualified, as Tier 2 instruments under Article 63 of the Commission Regulation (EU) No. 575/2013 (as amended from time to time) ("CRR") and form, or formed, a component of Tier 2 capital for the purposes of CRR.

Interest on debt securities having a maturity of not more than 364 days from the date of issue may also be paid without withholding or deduction for or on account of United Kingdom income tax, provided the debt securities are

not issued under arrangements the effect of which is to render such debt securities part of a borrowing with a total term of a year or more.

In addition to the exemptions described above, interest on the debt securities may be paid without withholding or deduction for or on account of United Kingdom income tax so long as:

(i) the issuer of the debt securities is authorized for the purposes of the United Kingdom Financial Services and Markets Act 2000 ("FSMA") and its business consists wholly or mainly of dealing in financial instruments (as defined by section 984 of the ITA) as principal and so long as such payments are made by the issuer of the debt securities in the ordinary course of that business. Barclays Bank PLC is currently authorized for the purposes of FSMA.

(ii) in respect of debt securities which are not regulatory capital securities", the interest on the debt securities is paid by a "bank" (as defined in section 991 of the ITA) in the ordinary course of its business. Barclays Bank PLC is currently a "bank" for the purposes of Section 991 of the ITA. In accordance with the published practice of HMRC, interest will be accepted as being paid by a "bank" in the ordinary course of business unless either (a) the borrowing in question conforms to any of the definitions of tier 1, 2 or 3 capital adopted by the PRA, whether or not it actually counts toward tier 1, 2 or 3 capital for regulatory purposes, or (b) the characteristics of the transaction giving rise to the interest are primarily attributable to an intention to avoid United Kingdom tax. In the technical note published in December 2013 in connection with the introduction of the 2013 Regulations, HMRC announced that the published practice referred to above will be withdrawn in due course and guidance will be issued reflecting HMRC's view on certain matters referenced therein.

In all other cases falling outside the exemptions described above, an amount must be withheld on account of United Kingdom income tax at the basic rate (currently 20%), subject to any such relief as may be available, or subject to any direction to the contrary by HMRC in respect of such relief as may be available pursuant to the provisions of any applicable double tax treaty.

Payments of interest made in respect of the debt securities may be subject to United Kingdom tax by direct assessment even where such payments are paid without withholding or deduction. However, as regards a holder of debt securities who is not resident in the United Kingdom for United Kingdom tax purposes, payments of interest made in respect of the debt securities without withholding or deduction will generally not be subject to United Kingdom tax provided that the relevant holder does not carry on a trade, profession or vocation in the United Kingdom through a branch or agency or (in the case of a company) carry on a trade or business in the United Kingdom through any permanent establishment in the United Kingdom, in each case in connection with which the interest is received or to which the debt securities are attributable, in which case (subject to exemptions for interest received by certain categories of agent) United Kingdom tax may be levied on the United Kingdom branch or agency, or permanent establishment.

Discount. The profit realized on any disposal (which includes redemption) of any Discount Security may attract withholding or deduction for or on account of United Kingdom income tax. However, even if it does not, it may be subject to United Kingdom tax by direct assessment to the same extent as interest which has a United Kingdom source.

Payments other than interest. Where a payment on a debt security does not constitute (or is not treated as) interest for United Kingdom tax purposes, it could potentially be subject to withholding or deduction for or on account of United Kingdom income tax if, for example, it constitutes (or is treated as) an annual payment, a manufactured payment, rent or royalties for United Kingdom tax purposes (which will be determined by, among other things, the terms and conditions specified in the pricing supplement of the debt securities). In such a case, the payment may fall to be made under withholding or deduction of United Kingdom income tax (the rate of withholding or deduction depending on the nature of the payment), subject to any exemption from withholding or deduction which may apply and to such relief as may be available under the provisions of any applicable double tax treaty. Holders of debt securities should seek their own professional advice as regards the United Kingdom tax treatment of (including any

withholding or deduction for or on account of United Kingdom tax from) any payment on the debt securities which does not constitute "interest" or "principal" as those terms are understood in United Kingdom tax law.

Disposal (including Redemption), Accruals and Changes in Value. A holder of debt securities who is not resident in the United Kingdom will not be liable to United Kingdom taxation in respect of a disposal (including redemption) of a debt security, any gain accrued in respect of a debt security or any change in the value of a debt security unless the holder carries on a trade, profession or vocation in the United Kingdom through a branch or agency or, in the case of a company, through a permanent establishment and the debt security was used in or for the purposes of this trade, profession or vocation or acquired for the use by or for the purposes of the branch or agency or permanent establishment.

Inheritance Tax. Where the debt securities are not situate in the United Kingdom, beneficial owners of such debt securities who are individuals not domiciled in the United Kingdom will not be subject to United Kingdom inheritance tax in respect of such debt securities. "Domicile" usually has an extended meaning in respect of United Kingdom inheritance tax, so that a person who has been resident for tax purposes in the United Kingdom for a certain period of time will be regarded as domiciled in the United Kingdom. Where the debt securities are situate in the United Kingdom, beneficial owners of such debt securities who are individuals may be subject to United Kingdom inheritance tax in respect of such debt securities on the death of the individual or, in some circumstances, if the debt securities are the subject of a gift, including a transfer at less than full market value, by that individual. United Kingdom inheritance tax is not generally chargeable on gifts to individuals made more than seven years before the death of the donor. Subject to limited exclusions, gifts to settlements (which would include, very broadly, private trust arrangements) or to companies may give rise to an immediate United Kingdom inheritance tax charge. Debt securities held in settlements may also be subject to United Kingdom inheritance tax charges periodically during the continuance of the settlement, on transfers out of the settlement or on certain other events. Investors should take their own professional advice as to whether any particular arrangements constitute a settlement for inheritance tax purposes.

Exemption from or reduction in any United Kingdom inheritance tax liability may be available for U.S. holders under the Estate Tax Treaty made between the United Kingdom and the United States.

Issue of debt securities—Stamp Duty. No United Kingdom stamp duty will generally be payable on the issue of debt securities provided that, in the case of bearer debt securities, a statutory exemption applies, such as the exemption for debt securities which constitute "loan capital" for the purposes of section 78(7) of the Finance Act 1986 or which are denominated in a currency other than sterling.

Issue of debt securities—Stamp Duty Reserve Tax. No United Kingdom stamp duty reserve tax will be payable on the issue of debt securities unless the debt securities are issued directly to the provider of a clearance service or its nominee. In that case, United Kingdom stamp duty reserve tax may be chargeable at the rate of 1.5% of the issue price of the debt securities (although see below, under "Preference Shares and ADSs—Stamp Duty Reserve Tax—Recent Court of Justice of the European Union Decision").

This charge may arise unless either (a) a statutory exemption is available or (b) the clearance service has made an election under section 97A of Finance Act 1986 which applies to the relevant debt securities. A statutory exemption from the charge will be available (i) if the relevant debt securities constitute "exempt loan capital" (see below, under "—Transfer of debt securities—Stamp Duty"), or (ii) for certain bearer securities provided certain conditions are satisfied (see below, under "—Preference Shares and ADSs—Stamp Duty Reserve Tax—Recent Court of Justice of the European Union Decision") or (iii) if the relevant debt securities constitute "regulatory capital securities" and certain conditions are met (see below, under "—Issue and Transfers of debt securities—Regulatory Capital Securities").

If this charge arises, the clearance service operator or its nominee will strictly be accountable for the stamp duty reserve tax, but in practice it will generally be reimbursed by participants in the clearance service.

Transfers of debt securities—Stamp Duty. No liability for United Kingdom stamp duty will arise on a transfer of, or an agreement to transfer, full legal and beneficial ownership of any debt securities, provided that the debt securities

constitute "exempt loan capital." Broadly, "exempt loan capital" is "loan capital" for the purposes of section 78(7) of the Finance Act 1986 which does not carry or (in the case of (ii), (iii) and (iv) below) has not at any time prior to the relevant transfer or agreement carried any of the following rights:

(i) a right of conversion into shares or other securities, or to the acquisition of shares or other securities, including loan capital of the same description;

(ii) a right to interest the amount of which exceeds a reasonable commercial return on the nominal amount of the capital;

(iii) a right to interest the amount of which falls or has fallen to be determined to any extent by reference to the results of, or of any part of, a business or to the value of any property; or

(iv) a right on repayment to an amount which exceeds the nominal amount of the capital and is not reasonably comparable with what is generally repayable (in respect of a similar nominal amount of capital) under the terms of issue of loan capital listed in the Official List of the FCA.

Even if a debt security does not constitute exempt loan capital (a "Non-Exempt Debt Security"), no United Kingdom stamp duty will arise on transfer of the debt security if the debt security is held within a clearing system and the transfer is effected by electronic means, without executing any written transfer of, or written agreement to transfer, the debt security.

However, if a Non-Exempt Debt Security is transferred by means of a written instrument, or a written agreement is entered into to transfer an interest in the debt security where such interest falls short of full legal and beneficial ownership of the debt security, the relevant instrument or agreement may be liable to United Kingdom stamp duty (at the rate of 0.5% of the consideration, rounded up if necessary to the nearest multiple of £5). If there is no United Kingdom register and the relevant instrument or agreement is executed and retained outside the United Kingdom at all times, no United Kingdom stamp duty should, in practice, need to be paid on such document. However, in the event that the relevant document is executed in or brought into the United Kingdom for any purpose, then United Kingdom stamp duty may be payable. Interest may also be payable on the amount of such stamp duty, unless the document is duly stamped within 30 days after the day on which it was executed. Penalties for late stamping may also be payable on the stamping of such document (in addition to interest) unless the document is duly stamped within 30 days after the day on which it was executed or, if the instrument was executed outside the United Kingdom, within 30 days of it first being brought into the United Kingdom. However, no United Kingdom stamp duty will be payable on any such written transfer, or written agreement to transfer, if the amount or value of the consideration for the transfer is £1,000 or under, and the document contains a statement that the transfer does not form part of a larger transaction or series of transactions in respect of which the amount or value, or aggregate amount or value, of the consideration exceeds £1,000.

In addition to the above, if a Non-Exempt Debt Security is in registered form, and the debt security is transferred, or agreed to be transferred, to a clearance service provider or its nominee, United Kingdom stamp duty may be chargeable (at the rate of 1.5% of the consideration for the transfer or, if none, of the value of the relevant debt securities, rounded up if necessary to the nearest multiple of £5) on any document effecting, or containing an agreement to effect, such a transfer.

If a document is subject to United Kingdom stamp duty, it may not be produced in civil proceedings in the United Kingdom, and may not be available for any other purpose in the United Kingdom, until the Untied Kingdom stamp duty (and any interest and penalties for late stamping) have been paid.

Transfers of debt securities—Stamp Duty Reserve Tax. No United Kingdom stamp duty reserve tax will be chargeable on the transfer of, or on an agreement to transfer, full legal and beneficial ownership of a debt security which constitutes "exempt loan capital."

If a debt security is a "Non-Exempt Debt Security," stamp duty reserve tax (at the rate of 0.5% of the consideration) may be chargeable on an unconditional agreement to transfer the debt security. An exemption from the charge is

available for certain securities in bearer form, provided certain conditions are satisfied. In addition, an exemption from the charge will be available if the debt securities are held within a clearance service, provided the clearance service has not made an election pursuant to section 97A of the Finance Act 1986 which applies to the relevant debt securities. Any liability to United Kingdom stamp duty reserve tax which arises on such an agreement may be removed if a transfer is executed pursuant to the agreement and either no United Kingdom stamp duty is chargeable on that transfer or the transfer is duly stamped within the prescribed time limits. Where United Kingdom stamp duty reserve tax arises, subject to certain exceptions, it is normally the liability of the purchaser or transferee of the debt securities.

In addition to the above, United Kingdom stamp duty reserve tax may be chargeable (at the rate of 1.5% of the consideration for the transfer or, if none, of the value of the relevant debt security) on the transfer of a Non-Exempt Debt Security to the provider of a clearance service or its nominee (although see below, under "Preference Shares and ADSs—Stamp Duty Reserve Tax—Recent Court of Justice of the European Union Decision"). This charge will arise unless either (a) a statutory exemption is available or (b) the clearance service has made an election under section 97A of Finance Act 1986 which applies to the relevant debt securities. A statutory exemption from the charge will be available for certain bearer securities provided certain conditions are satisfied. If this charge arises, the clearance service operator or its nominee will strictly be accountable for the stamp duty reserve tax, but in practice it will generally be reimbursed by participants in the clearance service.

Issue and Transfers of debt securities—"Regulatory Capital Securities". No liability to United Kingdom stamp duty or stamp duty reserve tax will arise on the issue or transfer of debt securities provided that the debt securities are "regulatory capital securities" for the purposes of the 2013 Regulations and there are no arrangements, the main purpose, or one of the main purposes, of which is to obtain a tax advantage as a result of the application of the 2013 Regulations in respect of the debt securities.

Redemption of debt securities—Stamp Duty and Stamp Duty Reserve Tax. No United Kingdom stamp duty or stamp duty reserve tax will generally be payable on the redemption of debt securities, provided no issue or transfer of shares or other securities is effected upon or in connection with such redemption.

Preference Shares and ADSs

Dividends. No withholding or deduction for or on account of United Kingdom tax will be made from payments of dividends on the preference shares or ADSs.

Holders of preference shares or ADSs who (a) are not resident in the United Kingdom for United Kingdom tax purposes and (b) who do not carry on a trade, profession or vocation in the United Kingdom or, in the case of companies, carry on a trade or business in the United Kingdom through a permanent establishment in the United Kingdom in connection with which the dividend is received or to which the preference shares or ADSs are attributable in the United Kingdom and who receive a dividend from us will not have any further United Kingdom tax to pay in respect of such dividend.

Disposals. Holders of preference shares or ADSs who are not resident in the United Kingdom will not normally be liable for United Kingdom tax on income or chargeable gains (or for any other United Kingdom tax upon a disposal or deemed disposal of or other return from preference shares or ADSs) unless they carry on a trade, profession or vocation in the United Kingdom through a branch or agency or, in the case of a company, through a permanent establishment, and the preference shares or ADSs are or have been used or held by or for the purposes of this trade, profession or vocation or acquired for the use and used by or for the purposes of the branch or agency or permanent establishment, in which case such holders of preference shares or ADSs might, depending on individual circumstances, be liable to United Kingdom tax on chargeable gains on any disposal (or deemed disposal) of preference shares or ADSs.

Inheritance Tax. It is not clear whether the situs of an ADS for United Kingdom inheritance tax purposes is determined by the place where the depositary is established and records the entitlements of the depositholders, or by the situs of the underlying share which the ADS represents. Where the preference shares or ADSs are not situate in the United Kingdom, beneficial owners of such preference shares or ADSs who are individuals not domiciled in the

United Kingdom will not be subject to United Kingdom inheritance tax in respect of such preference shares or ADSs. "Domicile" usually has an extended meaning in respect of United Kingdom inheritance tax, so that a person who has been resident for tax purposes in the United Kingdom for a certain period of time will be regarded as domiciled in the United Kingdom. Where the preference shares or ADSs are situate in the United Kingdom, beneficial owners of such preference shares or ADSs who are individuals may be subject to United Kingdom inheritance tax in respect of such preference shares or ADSs on the death of the individual or, in some circumstances, if the preference shares or ADSs are the subject of a gift, including a transfer at less than full market value, by that individual.

United Kingdom inheritance tax is not generally chargeable on gifts to individuals made more than seven years before the death of the donor.

Subject to limited exclusions, gifts to settlements (which would include, very broadly, private trust arrangements) or to companies may give rise to an immediate inheritance tax charge. Preference shares or ADSs held in settlements may also be subject to inheritance tax charges periodically during the continuance of the settlement, on transfers out of the settlement or on certain other events. Investors should take their own professional advice as to whether any particular arrangements constitute a settlement for inheritance tax purposes.

Exemption from or reduction in any United Kingdom inheritance tax liability may be available for U.S. holders under the Estate Tax Treaty made between the United Kingdom and the United States.

Stamp Duty and Stamp Duty Reserve Tax. Any documentary transfer of, or documentary agreement to transfer, any preference share or any interest in any preference share will generally be liable to United Kingdom stamp duty, generally at the rate of 0.5% of the amount or value of the consideration for the transfer (rounded up to the next multiple of £5). United Kingdom stamp duty will not be chargeable on any document effecting a transfer, or document containing an agreement to transfer the preference shares where the amount or value of the consideration for the transfer is £1,000 or under £1,000, and the document effecting the transfer contains a statement that the transfer does not form part of a larger transaction or series of transactions in respect of which the amount or value, or the aggregate amount or value, of the consideration exceeds £1,000. United Kingdom stamp duty is usually the liability of the purchaser or transferee of the shares. An unconditional agreement to transfer such preference shares will also generally be subject to United Kingdom stamp duty reserve tax, generally at the rate of 0.5% of the amount or value of the consideration for the transfer, but such liability will be cancelled, or, if already paid, will generally be refunded, if the agreement is completed by a duly stamped transfer within six years of the agreement having become unconditional. United Kingdom Stamp duty reserve tax is normally the liability of the purchaser or transferee of the shares.

Where we issue preference shares, or a holder of preference shares transfers such preference shares, to an ADR issuer, a liability for United Kingdom stamp duty or stamp duty reserve tax at the rate of 1.5% (rounded up to the next multiple of £5 in the case of stamp duty) of either the issue price or, in the case of a transfer, the amount or value of the consideration for the transfer, or the value of the preference shares, may arise. Any such liability for United Kingdom stamp duty or stamp duty reserve tax will strictly be the liability of the ADR issuer (or their nominee or agent). However, in practice, (i) where preference shares are issued to an ADR issuer, we will reimburse the ADR issuer or otherwise bear the cost and (ii) where preference shares are transferred to an ADR issuer, the liability for payment of the United Kingdom stamp duty or stamp duty reserve tax will depend on the arrangements in place between the seller, the ADR issuer and the purchaser.

Where we issue preference shares, or a holder of preference shares transfers such preference shares, to a person providing clearance services (or their nominee or agent) and where the person providing clearance services has not made an election under section 97A Finance Act 1986, a liability for United Kingdom stamp duty or stamp duty reserve tax at the rate of 1.5% (rounded up to the next multiple of £5 in the case of stamp duty) of either the issue price or, in the case of a transfer, the amount or value of the consideration for the transfer, or the value of the preference shares, may arise (although see below, under "—Stamp Duty Reserve Tax—Recent Court of Justice of the European Union Decision"). Any such liability for United Kingdom stamp duty or stamp duty reserve tax will strictly be the liability of the person providing clearance services (or their nominee or agent). However, in practice, (i) where preference shares are issued to a person providing clearance services (or their nominee or agent), we will

reimburse the person providing clearing services or otherwise bear the cost and (ii) where preference shares are transferred to a person providing clearance services (or their nominee or agent), the liability for payment of the United Kingdom stamp duty or stamp duty reserve tax will depend on the arrangements in place between the seller, the person providing clearance services and the purchaser. Transfers of preference shares within a clearance system are generally outside the scope of stamp duty as long as there is no instrument of transfer, and are exempt from stamp duty reserve tax.

Where we issue preference shares, or a holder of preference shares transfers such preference shares, to a person providing clearance services (or their nominee or agent), and that person has made an election under section 97A Finance Act 1986, there will be no liability for United Kingdom stamp duty or stamp duty reserve tax at the rate of 1.5% of either the issue price or, in the case of a transfer, the amount or value of the consideration for the transfer, or the value of the preference shares. However, in such case, a liability for United Kingdom stamp duty or stamp duty reserve tax at a rate of 0.5% may arise on the transfer of, or agreement to transfer, preference shares within the clearance system (as set out in the first paragraph under the sub-section "—Stamp Duty and Stamp Duty Reserve Tax").

No liability for United Kingdom stamp duty or stamp duty reserve tax will arise on a transfer of ADSs, provided that any document that effects such transfer is not executed in the United Kingdom and that it remains at all subsequent times outside the United Kingdom. An agreement to transfer ADSs will not give rise to a liability for stamp duty reserve tax.

Stamp Duty Reserve Tax—Recent Court of Justice of the European Union Decision. The Court of Justice of the European Union ("CJEU") gave its decision in the case of *HSBC Holdings plc, Vidacos Nominees Ltd v. The Commissioners of Her Majesty's Revenue & Customs* (Case C – 596/07) on October 1, 2009. In summary, it stated that the 1.5% charge to United Kingdom stamp duty reserve tax on the issue of shares to a clearance service is incompatible with the EC Capital Duty Directive.

On April 27, 2012, following the decision of the First-tier Tribunal (Tax Chamber) in *HSBC Holdings PLC and The Bank of New York Mellon Corporation v. The Commissioners for Her Majesty's Revenue & Customs* [2012] UKFTT 163 (TC), HMRC announced that the 1.5% stamp duty reserve tax charge is no longer applicable to the issue of United Kingdom shares and securities to clearance services or depositary receipt systems anywhere in the world.

The CJEU made no express comment with respect to the compatibility with EC law of the 1.5% United Kingdom stamp duty reserve tax charge on the transfer of existing securities to (as opposed to issue of new securities into) a clearance system. The position, in this regard, is therefore unclear, although HMRC's view is that both the 1.5% United Kingdom stamp duty and depositary receipt systems charges continue to apply to the transfer of shares and securities to clearance services that are not an integral part of an issue of share capital.

HMRC have also stated in an earlier press release that the Government's policy position remains that transactions involving United Kingdom shares should bear their fair share of tax and that they are considering further changes to the United Kingdom stamp duty reserve tax regime in the light of this decision. Such changes may affect any aspects of the United Kingdom stamp duty and stamp duty reserve tax regimes but the 1.5% charges to United Kingdom stamp duty and stamp duty reserve tax referred to in this opinion would seem particularly likely to be affected.

Specific professional advice should be sought before paying the 1.5% United Kingdom stamp duty reserve tax charge in any circumstances.

Other tax considerations

The proposed financial transactions tax ("FTT")

On February 14, 2013, the European Commission published a proposal (the "Commission's proposal") for a Directive for a common FTT in Belgium, Germany, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (the "participating Member States") and Estonia. However, Estonia has since stated that it will not participate.

The Commission's proposal has very broad scope and could, if introduced, apply to certain dealings in the notes (including secondary market transactions) in certain circumstances.

Under the Commission's proposal, the FTT could apply in certain circumstances to persons both within and outside of the participating Member States. Generally, it would apply to certain dealings in the notes where at least one party is a financial institution, and at least one party is established in a participating Member State. A financial institution may be, or be deemed to be, "established" in a participating Member State in a broad range of circumstances, including (a) by transacting with a person established in a participating Member State or (b) where the financial instrument which is subject to the dealings is issued in a participating Member State.

However, the FTT proposal remains subject to negotiation between the participating Member States. It may therefore be altered prior to any implementation, the timing of which remains unclear. Additional EU Member States may decide to participate.

Prospective holders of the notes are advised to seek their own professional advice in relation to the FTT.

EMPLOYEE RETIREMENT INCOME SECURITY ACT

Each fiduciary of a pension, profit-sharing or other employee benefit plan (a "Plan") subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), should consider the fiduciary standards of ERISA in the context of the Plan's particular circumstances before authorizing an investment in the securities. Among other factors, the fiduciary should consider whether the investment would satisfy the prudence and diversification requirements of ERISA and would be consistent with the documents and instruments governing the plan, and whether the investment would involve a prohibited transaction under Section 406 of ERISA or Section 4975 of the Code.

Section 406 of ERISA and Section 4975 of the Code prohibit Plans, as well as individual retirement accounts, Keogh plans and any other plans subject to Section 4975 of the Code (also "Plans") from engaging in certain transactions involving "plan assets" with persons who are "parties in interest" under ERISA or "disqualified persons" under the Code with respect to the Plan. A violation of these prohibited transaction rules may result in civil penalties or other liabilities under ERISA and/or an excise tax under Section 4975 of the Code for those persons, unless relief is available under an applicable statutory or administrative exemption. Employee benefit plans and arrangements that are governmental plans (as defined in section 3(32) of ERISA), certain church plans (as defined in Section 3(33) of ERISA) and foreign plans (as described in Section 4(b)(4) of ERISA) ("Non-ERISA Arrangements") are not subject to the requirements of ERISA or Section 4975 of the Code but may be subject to similar provisions under applicable federal, state, local, non-U.S. or other regulations, rules or laws ("Similar Laws").

Barclays Bank PLC, Barclays Capital Inc. and certain of their affiliates, among others, may each be considered a party in interest or a disqualified person with respect to many Plans. The acquisition or holding of the securities by a Plan or any entity whose underlying assets include "plan assets" by reason of any Plan's investment in the entity (a "Plan Asset Entity") with respect to which Barclays Bank PLC, Barclays Capital Inc. or certain of their affiliates is or becomes a party in interest or disqualified person may constitute or result in prohibited transaction under ERISA or Section 4975 of the Code, unless those securities are acquired and held pursuant to an applicable statutory or administrative exemption.

The U.S. Department of Labor has issued five prohibited transaction class exemptions, or "PTCEs," that may provide exemptive relief if required for direct or indirect prohibited transactions that may arise from the purchase or holding of the securities. These exemptions are:

(1) PTCE 84-14, an exemption for certain transactions determined or effected by independent qualified professional asset managers;

(2) PTCE 90-1, an exemption for certain transactions involving insurance company pooled separate accounts;

(3) PTCE 91-38, an exemption for certain transactions involving bank collective investment funds;

(4) PTCE 95-60, an exemption for transactions involving certain insurance company general accounts; and

(5) PTCE 96-23, an exemption for plan asset transactions managed by in-house asset managers.

In addition, ERISA Section 408(b)(17) and Section 4975(d)(20) of the Code provide an exemption for the acquisition and disposition of the securities, provided that neither Barclays Bank PLC, Barclays Capital Inc. nor any of their affiliates have or exercise any discretionary authority or control or render any investment advice with respect to the assets of any Plan involved in the transaction, and provided further that the Plan pays no more and receives no less than "adequate consideration" in connection with the transaction (the "service provider exemption"). There can be no assurance that all of the conditions of any of the above exemptions (or any other exemption) will be satisfied.

Because of the foregoing, the securities should not be acquired or held by any person investing "plan assets" of any Plan, Plan Asset Entity or Non-ERISA Arrangement, unless such acquisition and holding will not constitute a non-exempt prohibited transaction under ERISA and the Code or similar violation of any applicable Similar Laws.

Any purchaser or holder of the securities or any interest in the securities will be deemed to have represented by its purchase and holding of the securities that it either (i) is not a Plan, a Plan Asset Entity or a Non-ERISA Arrangement and is not purchasing those securities on behalf of or with "plan assets" of any Plan, Plan Asset Entity or Non-ERISA Arrangement or (ii) any such purchase or holding, will not result in a non-exempt prohibited transaction under the rules described above or a violation of any applicable Similar Laws. Further, any person acquiring or holding the securities on behalf of any Plan or with any plan assets shall be deemed to represent on behalf of itself and such Plan that (x) the Plan is paying no more than, and is receiving no less than, adequate consideration within the meaning of Section 408(b)(17) of ERISA in connection with the transaction or any redemption of the securities, (y) neither Barclays Bank PLC, Barclays Capital Inc. or any placement agent, nor any of their affiliates directly or indirectly exercises any discretionary authority or control or renders investment advice or otherwise acts in a fiduciary capacity with respect to the assets of the Plan within the meaning of ERISA and (z) in making the foregoing representations and warranties, such person has applied sound business principles in determining whether fair market value will be paid, and has made such determination acting in good faith.

Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt prohibited transactions, it is important that fiduciaries or other persons considering purchasing the securities on behalf of or with "plan assets" of any Plan, Plan Asset Entity or Non-ERISA Arrangement consult with their counsel regarding the availability of exemptive relief under any of the PTCEs listed above, the service provider exemption, or any other applicable exemption, or the potential consequences of any purchase or holding under applicable Similar Laws.

Purchasers of the securities have exclusive responsibility for ensuring that their acquisition and holding of the securities do not violate the fiduciary or prohibited transaction rules of ERISA or the Code or any similar provisions of Similar Laws. The sale of any security to a Plan or a Non-ERISA Arrangement is in no respect a representation by Barclays Bank PLC, Barclays Capital Inc. or any of their affiliates that the investment meets all relevant legal requirements with respect to investments by Plans or Non-ERISA Arrangements generally or any particular Plan or Non-ERISA Arrangement, or that the investment is appropriate for a Plan or a Non-ERISA Arrangement generally or any particular Plan or Non-ERISA Arrangement.

If you are an insurance company or the fiduciary of a pension plan or an employee benefit plan, and propose to invest in the securities, you should consult your legal counsel.

The applicable prospectus supplement and pricing supplement may contain a further discussion of ERISA and Similar Laws.

PLAN OF DISTRIBUTION

Initial Offering and Issue of Securities

We may issue all or part of the securities from time to time, on terms determined at that time, through underwriters, dealers and/or agents, directly to purchasers or through a combination of any of these methods. We will set forth in the applicable prospectus supplement:

- the terms of the offering of the securities;
- the names of any underwriters, dealers or agents involved in the sale of the securities;
- the principal amounts of securities any underwriters will subscribe for; and
- our net proceeds.

If we use underwriters in the issue, they will acquire the securities for their own account and they may effect distribution of the securities from time to time in one or more transactions. These transactions may be at a fixed price or prices, which they may change, or at prevailing market prices, or related to prevailing market prices, or at negotiated prices. The securities may be offered to the public either through underwriting syndicates represented by managing underwriters or underwriters without a syndicate. Unless the applicable prospectus supplement specifies otherwise, the underwriters' obligations to subscribe for the securities will depend on certain conditions being satisfied. If the conditions are satisfied, the underwriters will be obligated to subscribe for all of the securities of the series, if they subscribe for any of them. The initial public offering price of any securities and any discounts or concessions allowed or reallowed or paid to dealers may change from time to time.

If we use dealers in the issue, unless the applicable prospectus supplement specifies otherwise, we will issue the securities to the dealers as principals. The dealers may then sell the securities to the public at varying prices that the dealers will determine at the time of sale.

We may also issue securities through agents we designate from time to time, or we may issue securities directly. The applicable prospectus supplement will name any agent involved in the offering and issue of the securities, and will also set forth any commissions that we will pay. Unless the applicable prospectus supplement indicates otherwise, any agent will be acting on a best efforts basis for the period of its appointment. Agents through whom we issue securities may enter into arrangements with other institutions with respect to the distribution of the securities, and those institutions may share in the commissions, discounts or other compensation received by our agents, may be compensated separately and may also receive commissions from the purchasers for whom they may act as agents.

In connection with the issue of securities, underwriters may receive compensation from us or from subscribers of securities for whom they may act as agents. Compensation may be in the form of discounts, concessions or commissions. Underwriters may sell securities to or through dealers, and these dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters. Dealers may also receive commissions from the subscribers for whom they may act as agents. Underwriters, dealers and agents that participate in the distribution of securities may be deemed to be underwriters, and any discounts or commissions received by them from us and any profit on the sale of securities by them may be deemed to be underwriting discounts and commissions under the Securities Act. The prospectus supplement will identify any underwriter or agent, and describe any compensation that we provide.

If the applicable prospectus supplement so indicates, we will authorize underwriters, dealers or agents to solicit offers to subscribe the securities from institutional investors. In this case, the prospectus supplement will also indicate on what date payment and delivery will be made. There may be a minimum amount which an institutional investor may subscribe, or a minimum portion of the aggregate principal amount of the securities which may be issued by this type of arrangement. Institutional investors may include commercial and savings banks, insurance companies, pension funds, investment companies, educational and charitable institutions and any other institutions we may approve. The subscribers' obligations under delayed delivery and payment arrangements will not be subject

to any conditions; however, the institutional investors' subscription of particular securities must not at the time of delivery be prohibited under the laws of any relevant jurisdiction in respect, either of the validity of the arrangements, or the performance by us or the institutional investors under the arrangements.

We may enter into agreements with the underwriters, dealers and agents who participate in the distribution of the securities that may fully or partially indemnify them against some civil liabilities, including liabilities under the Securities Act. Underwriters, dealers and agents may be customers of, engage in transactions with, or perform services for, or be affiliates of Barclays PLC and the Barclays Bank Group in the ordinary course of business.

Barclays Capital Inc. is a subsidiary of Barclays PLC and may participate in one or more offerings of our securities. Rule 5121 of the consolidated rulebook of the Financial Industry Regulatory Authority ("FINRA") (or any successor rule thereto) ("Rule 5121") imposes certain requirements when a FINRA member, such as Barclays Capital Inc., distributes an affiliated company's securities, such as our securities. Barclays Capital Inc. has advised us that each particular offering of securities in which it participates will comply with the applicable requirements of Rule 5121.

Barclays Capital Inc. will not confirm initial issues to accounts over which it exercises discretionary authority without the prior written approval of the customer.

Selling Restrictions

Unless the applicable prospectus supplement specifies otherwise, we will not offer the securities or any investments representing securities, including ADSs or ADRs, of any series to the public in the United Kingdom or any member state of the European Economic Area ("EEA") which has implemented Directive 2003/71/EC (the "Prospectus Directive").

Selling Restrictions Addressing United Kingdom Securities Laws

Unless otherwise specified in any agreement between us and the underwriters, dealers and/or agents in relation to the distribution of the securities or any investments representing securities, including ADSs or ADRs, of any series and subject to the terms specified in the agreement, any underwriter, dealer or agent in connection with an offering of securities or any investments representing securities, including ADSs or ADRs, of any series will confirm and agree that:

- it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of any securities or any investments representing securities, including ADSs or ADRs, in circumstances in which Section 21(1) of the FSMA would not, if we were not an "authorized person" under the FSMA, apply to us; and

- it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the securities, or any investments representing securities, including ADSs and ADRs in, from or otherwise involving the United Kingdom.

Public Offer Selling Restriction Under The Prospectus Directive

Unless otherwise specified in any agreement between us and the underwriters, dealers and/or agents in relation to the distribution of the securities or any investments representing securities, including ADSs or ADRs, of any series and subject to the terms specified in the agreement, in relation to each member state of the European Economic Area which has implemented the Prospectus Directive (each, a "Relevant Member State"), any underwriter, dealer or agent in connection with an offering of securities or any investments representing securities, including ADSs or ADRs, of any series will confirm and agree that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the "relevant implementation date") it has not made and will not make an offer of any securities or any investments representing securities which are the subject of the offering contemplated by the prospectus as completed by the prospectus supplement in relation thereto to the public

in that Relevant Member State except that it may, with effect from and including the relevant implementation date, make an offer of the securities to the public in that Relevant Member State:

- to any legal entity which is a qualified investor as defined in the Prospectus Directive;
- to fewer than 100 or, if the Relevant Member State has implemented the relevant provision of the 2010 PD Amending Directive, 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive), as permitted under the Prospectus Directive, subject to obtaining the prior consent of the relevant underwriter or underwriters nominated by Barclays Bank PLC for any such offer; or
- in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of securities referred to in the bullet points above shall require us or any underwriter, dealer and/or agent to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

The expression "an offer of any securities or any investments representing securities to the public" in relation to such securities or investments in any relevant member state means the communication in any form and by any means of sufficient information on the terms of the offer and the securities or investments to be offered so as to enable an investor to decide to purchase or subscribe the securities or investments, as the same may be varied in that member state by any measure implementing the Prospectus Directive in that member state and the expression "Prospectus Directive" means Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in the relevant member state), and includes any relevant implementing measure in the Relevant Member State and the expression "2010 PD Amending Directive" means Directive 2010/73/EU.

Market-Making Resales

This prospectus may be used by an affiliate of Barclays Bank PLC in connection with offers and sales of the securities in market-making transactions. In a market-making transaction, such affiliate may resell a security it acquires from other holders, after the original offering and sale of the security. Resales of this kind may occur in the open market or may be privately negotiated, at prevailing market prices at the time of resale or at related or negotiated prices. In these transactions, such affiliate may act as principal, or agent, including as agent for the counterparty in a transaction in which such affiliate acts as principal, or as agent for both counterparties in a transaction in which such affiliate does not act as principal. Such affiliate may receive compensation in the form of discounts and commissions, including from both counterparties in some cases.

The indeterminate aggregate initial offering price relates to the initial offering of the securities described in the prospectus supplement. This amount does not include securities sold in market-making transactions. The latter include securities to be issued after the date of this prospectus, as well as securities previously issued.

Barclays Bank PLC may receive, directly or indirectly, all or a portion of the proceeds of any market-making transactions by its affiliates.

Information about the trade and settlement dates, as well as the purchase price, for a market-making transaction will be provided to the purchaser in a separate confirmation of sale.

Unless we or an agent informs you in your confirmation of sale that your security is being purchased in its original offering and sale, you may assume that you are purchasing your security in a market-making transaction.

Matters Relating to Initial Offering and Market-Making Resales

Each series of securities will be a new issue, and there will be no established trading market for any security prior to its original issue date. We may choose not to list a particular series of securities on a securities exchange or quotation system. We have been advised by Barclays Capital Inc. that it intends to make a market in the securities,

and any underwriters to whom we sell securities for public offering or broker-dealers may also make a market in those securities. However, neither Barclays Capital Inc. nor any underwriter or broker-dealer that makes a market is obligated to do so, and any of them may stop doing so at any time without notice. We cannot give any assurance as to the liquidity of the trading market for the securities.

Unless otherwise indicated in the applicable prospectus supplement or confirmation of sale, the purchase price of the securities will be required to be paid in immediately available funds in New York City.

In this prospectus or any accompanying prospectus supplement, the terms "this offering" means the initial offering of securities made in connection with their original issuance. This term does not refer to any subsequent resales of securities in market-making transactions.

SERVICE OF PROCESS AND ENFORCEMENT OF LIABILITIES

We are an English public limited company. Substantially all of our directors and executive officers and a number of the experts named in this document are non-residents of the United States. All or a substantial portion of the assets of those persons are located outside the United States. Most of our assets are located outside of the United States. As a result, it may not be possible for you to effect service of process within the United States upon those persons or to enforce against them judgments of U.S. courts based upon the civil liability provisions of the federal securities laws of the United States. We have been advised by our English solicitors, Clifford Chance LLP, that there is doubt as to the enforceability in the United Kingdom, in original actions or in actions for enforcement of judgments of U.S. courts, of liabilities based solely upon the federal securities laws of the United States.

WHERE YOU CAN FIND MORE INFORMATION

We are subject to the information requirements of the Exchange Act. Accordingly, we file jointly with Barclays PLC, reports and other information with the SEC.

The SEC maintains an internet site at http://www.sec.gov that contains reports and other information we file electronically with the SEC. You may also inspect and copy reports and other information that we file with the SEC at the public reference facilities maintained at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. Copies of such material may be obtained by mail from the Public Reference Section of the SEC at 100 F Street, N.E., Room 1580, Washington, D.C. 20549 at prescribed rates. In addition, you may inspect and copy that material at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005, on which some of our securities are listed.

We will furnish to the debt trustee and warrant trustee referred to under "Description of Debt Securities" and "Description of Warrants" annual reports, which will include a description of operations and annual audited consolidated financial statements prepared in accordance with IFRS. We will also furnish to the debt trustee and warrant trustee interim reports that will include unaudited interim summary consolidated financial information prepared in accordance with IFRS. We will furnish to the debt trustee and warrant trustee all notices of meetings at which holders of securities are entitled to vote, and all other reports and communications that are made generally available to those holders.

FURTHER INFORMATION

We have filed with the SEC a registration statement on Form F-3 with respect to the securities offered with this prospectus. This prospectus is a part of that registration statement and it omits some information that is contained in the registration statement. You can access the registration statement together with exhibits on the internet site maintained by the SEC at http://www.sec.gov or inspect these documents at the offices of the SEC in order to obtain that additional information about us and about the securities offered with this prospectus.

VALIDITY OF SECURITIES

If stated in the prospectus supplement applicable to a specific issuance of debt securities or warrants, the validity of such securities under New York law may be passed upon for us by our U.S. counsel, Sullivan & Cromwell LLP. If stated in the prospectus supplement applicable to a specific issuance of debt securities or warrants, the validity of such securities under English law may be passed upon by our English solicitors, Clifford Chance LLP. Sullivan & Cromwell LLP may rely on the opinion of Clifford Chance LLP as to all matters of English law and Clifford Chance LLP may rely on the opinion of Sullivan & Cromwell LLP as to all matters of New York law. If this prospectus is delivered in connection with an underwritten offering, the validity of the debt securities or warrants may be passed upon for the underwriters by United States and English counsel for the underwriters specified in the related prospectus supplement.

EXPERTS

The financial statements and management's assessment of the effectiveness of internal control over financial reporting (which is included in Management's Report on Internal Control over Financial Reporting) of Barclays PLC and the financial statements of Barclays Bank PLC incorporated in this Prospectus by reference to the Annual Report of Barclays PLC and Barclays Bank PLC on Form 20-F for the year ended December 31, 2015 have been so incorporated in reliance on the reports of PricewaterhouseCoopers LLP, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

EXPENSES OF ISSUANCE AND DISTRIBUTION

The following is a statement of the expenses (all of which are estimated), other than any underwriting discounts and commission and expenses reimbursed by us, to be incurred in connection with a distribution of an assumed amount of $100,000,000 of securities registered under this registration statement:

Securities and Exchange Commission registration fee	$	(1)
Printing expenses		13,000
Legal fees and expenses		95,000
Accountants' fees and expenses		51,000
Trustee fees and expenses		10,000
Miscellaneous		20,000
Total	$	189,000

(1) Deferred in accordance with Rule 456(b) and 457(r) under the Securities Act.

BARCLAYS BANK PLC

GLOBAL MEDIUM-TERM NOTES, SERIES A

UNIVERSAL WARRANTS

Prospectus Supplement

Prospectus

BofA Merrill Lynch

July 18, 2016

$250,000,000

BARCLAYS BANK PLC

iPath® EUR/USD Exchange Rate ETN

GLOBAL MEDIUM-TERM NOTES, SERIES A

Pricing Supplement

July 18, 2016

(to Prospectus dated July 18, 2016 and Prospectus Supplement dated July 18, 2016)

Patent Pending

424B3 1 d424b3.htm PRICING SUPPLEMENT - IPATH EUR/USD EXCHANGE RATE ETN

Table of Contents

Filed Pursuant to Rule 424(b)(3)
File Number 333-126811


Pricing Supplement to the Prospectus
dated September 21, 2005
and the Prospectus Supplement
dated November 1, 2006

$250,000,000

iPath℠ EUR/USD Exchange Rate ETN

The iPath℠ Exchange-Traded Notes due May 14, 2037 (the "Securities") are linked to the euro / U.S. dollar exchange rate, do not guarantee any return of principal at maturity and do not pay any interest during their term. Instead, you will receive a cash payment at maturity or upon early redemption based on the performance of the euro / U.S. dollar exchange rate, an accumulation component and an investor fee. The principal terms of the Securities are as follows:

Issuer: Barclays Bank PLC

Series: Medium-Term Notes, Series A

Underlying Index: The return on the Securities is linked to the performance of the euro / U.S. dollar exchange rate (the "EUR/USD exchange rate" or the "Index"). The EUR/USD exchange rate is a foreign exchange spot rate that measures the relative values of two currencies, the euro and the U.S. dollar. When the euro appreciates relative to the U.S. dollar, the EUR/USD exchange rate (and the value of the Securities) increases; when the euro depreciates relative to the U.S. dollar, the EUR/USD exchange rate (and the value of the Securities) decreases. The EUR/USD exchange rate is expressed as a rate that reflects the number of U.S. dollars that can be exchanged for one euro in the interbank market for settlement in two days, as reported each day shortly after 10:00 a.m. on Reuters page 1FED or any successor page.

Payment at Maturity: If you hold your Securities to maturity, you will receive a cash payment equal to (1) the principal amount of your Securities *times* (2) the index factor on the final valuation date *minus* (3) the investor fee on the final valuation date.

Secondary Market: We plan to apply to list the Securities on the New York Stock Exchange under the ticker symbol ERO. If our application is approved and an active secondary market in the Securities develops, we expect that investors will purchase and sell the Securities primarily in this secondary market.

Early Redemption: Subject to the notification requirements described in this pricing supplement, you may redeem your Securities on any redemption date during the term of the Securities. If you redeem your Securities, you will receive a cash payment in an amount equal to the weekly redemption value, which equals (1) the principal amount of your Securities *times* (2) the index factor on the applicable valuation date *minus* (3) the investor fee on the applicable valuation date. You must redeem at least 50,000 Securities at one time in order to exercise your right to redeem your Securities on any redemption date.

Redemption Mechanics: In order to redeem your Securities on a redemption date, you must deliver a notice of redemption to us via email by no later than 11:00 a.m. on the business day prior to the applicable valuation date and follow the procedures set forth under "Specific Terms of the Securities – Redemption Procedures". If you fail to comply with these procedures, your notice will be deemed ineffective.

Valuation Date: Valuation date means each Thursday from May 17, 2007 to May 7, 2037, inclusive or, if such date is not a trading day, the next succeeding trading day, not to exceed five business days. We refer to Thursday, May 7, 2037, as the "final valuation date".

Redemption Date: A redemption date is the third business day following a valuation date (other than the final valuation date). The final redemption date will be the third business day following the valuation date that is immediately prior to the final valuation date.

Currency Component: The currency component on any given day will be equal to the EUR/USD exchange rate on that day (or, if such day is not a trading day, the EUR/USD exchange rate on the immediately preceding trading day) *divided by* the EUR/USD exchange rate on the inception date.

Accumulation Component: The accumulation component will be calculated on a daily basis in the following manner: The accumulation component on the inception date will equal one. On each subsequent business day until maturity or early redemption, the accumulation

component will equal (1) the accumulation component on the immediately preceding business day *times* (2) the sum of one *plus* the product of the deposit rate *times* the relevant daycount fraction.

Index Factor: The index factor on any given day will be equal to the currency component on that day *times* the accumulation component on that day.

Deposit Rate: The deposit rate on any given day will be equal to the European Overnight Index Average, as reported on Reuters page EONIA or any successor page on the immediately preceding business day (the "EONIA"), *minus* 0.25%. The deposit rate is intended to represent the actual rate that would be paid by a bank on an overnight deposit of euros.

Investor Fee: The investor fee is equal to 0.40% per year *times* the principal amount of your Securities *times* the index factor, calculated on a daily basis in the following manner: The investor fee on the inception date will equal zero. On each subsequent calendar day until maturity or early redemption, the investor fee will increase by an amount equal to (1) 0.40% *times* (2) the principal amount of your Securities *times* (3) the index factor on that day (or, if such day is not a trading day, the index factor on the immediately preceding trading day) *divided by* (4) 365.

Because the investor fee reduces the amount of your return at maturity or upon redemption, the EUR/USD exchange rate may need to increase significantly in order for you to receive at least the principal amount of your investment at maturity or upon redemption. If the increase in the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) is insufficient to offset the negative effect of the investor fee, or the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) decreases, you will receive less than the principal amount of your investment at maturity or upon redemption.

Daycount Fraction: The daycount fraction on any business day will be the number of calendar days that have elapsed since the immediately preceding business day *divided by* 365.

Trading Day: A trading day is a day on which (i) the EUR/USD exchange rate is reported on Reuters page 1FED or any successor page, (ii) trading is generally conducted on the New York Stock Exchange and (iii) trading is generally conducted in the interbank market, in each case as determined by the calculation agent in its sole discretion.

Inception Date: May 8, 2007.

CUSIP Number: 06739F184

ISIN: GB00B1WPBD95

You may lose some or all of your principal if you invest in the Securities. See " Risk Factors" beginning on page PS-10 of this pricing supplement for risks relating to an investment in the Securities.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined that this pricing supplement is truthful or complete. Any representation to the contrary is a criminal offense.

Patent pending

Pricing Supplement dated May 8, 2007
Issued in denominations of $50

Table of Contents

Cover Page, continued:

We intend to sell a portion of the Securities on the inception date at 100% of their stated principal amount. The remainder of the Securities will be offered and sold from time to time through Barclays Capital Inc., our affiliate, as agent. Sales of the Securities after the inception date will be made at market prices prevailing at the time of sale, at prices related to market prices or at negotiated prices. We will receive proceeds equal to 100% of the price at which the Securities are sold to the public. Barclays Capital Inc. will not receive an agent's commission in connection with sales of the Securities. Barclays Global Investors Services, an affiliate of Barclays Bank PLC and a member of NASD, Inc., may receive a portion of the investor fee. Please see "Supplemental Plan of Distribution" in this pricing supplement for more information.

We may use this pricing supplement in the initial sale of Securities. In addition, Barclays Capital Inc. or another of our affiliates may use this pricing supplement in market-making transactions in any Securities after their initial sale. ***Unless we or our agent informs you otherwise in the confirmation of sale or in a notice delivered at the same time as the confirmation of sale, this pricing supplement is being used in a market-making transaction.***

The Securities are not deposit liabilities of Barclays Bank PLC and are not insured by the United States Federal Deposit Insurance Corporation or any other governmental agency of the United States, the United Kingdom or any other jurisdiction.

Table of Contents

TABLE OF CONTENTS

PRICING SUPPLEMENT

PROSPECTUS SUPPLEMENT

PROSPECTUS

Table of Contents

PRICING SUPPLEMENT SUMMARY

The following is a summary of terms of the iPath[SM] Exchange-Traded Notes due May 14, 2037 (the "Securities") and linked to the euro / U.S. dollar exchange rate (the "EUR/USD exchange rate" or the "Index") as well as a discussion of risks and other considerations you should take into account when deciding whether to invest in the Securities. The information in this section is qualified in its entirety by the more detailed explanations set forth elsewhere in this pricing supplement and the accompanying prospectus and prospectus supplement. References to the "prospectus" mean our accompanying prospectus, dated September 21, 2005, and references to the "prospectus supplement" mean our accompanying prospectus supplement, dated November 1, 2006, which supplements the prospectus.

We may, without your consent, create and issue additional securities having the same terms and conditions as the Securities. We may consolidate the additional securities to form a single class with the outstanding Securities.

This section summarizes the following aspects of the Securities:

- What are the Securities and how do they work?
- How do you redeem your Securities?
- What are some of the risks of the Securities?
- Is this the right investment for you?
- What are the tax consequences?
- What is the euro?
- What does the EUR/USD exchange rate reflect?
- How do the Securities perform?

What Are the Securities and How Do They Work?

The Securities are medium-term notes that are uncollateralized debt securities and are linked to the performance of the EUR/USD exchange rate. The Securities will be issued in denominations of $50.

The EUR/USD exchange rate is a foreign exchange spot rate that measures the relative values of two currencies, the euro and the U.S. dollar. When the euro appreciates relative to the U.S. dollar, the EUR/USD exchange rate (and the value of the Securities) increases; when the euro depreciates relative to the U.S. dollar, the EUR/USD exchange rate (and the value of the Securities) decreases. The EUR/USD exchange rate is expressed as a rate that reflects the number of U.S. dollars that can be exchanged for one euro in the interbank market for settlement in two days, as reported each day shortly after 10:00 a.m. on Reuters page 1FED or any successor page.

If you have not previously redeemed your Securities, you will receive a cash payment at maturity equal to (1) the principal amount of your Securities *times* (2) the index factor on the final valuation date *minus* (3) the investor fee on the final valuation date. Prior to maturity, you may, subject to certain restrictions, redeem your Securities on any redemption date during the term of the Securities, provided that you present at least 50,000 Securities for redemption, or your broker or other financial intermediary (such as a bank or other financial institution not required to register as a broker-dealer to engage in securities transactions) bundles your Securities for redemption with those of other investors to reach this minimum. If you choose to redeem your Securities on a redemption date, you will receive a cash payment on such date in an amount equal to the weekly redemption value, which equals (1) the principal amount of your Securities *times* (2) the index factor on the applicable valuation date *minus* (3) the investor fee on the applicable valuation date.

The currency component on any given day will be equal to the EUR/USD exchange rate on that day (or, if such day is not a trading day, the EUR/USD exchange rate on the immediately preceding trading day) *divided by* the EUR/USD exchange rate on the inception date.

The accumulation component will be calculated on a daily basis in the following manner: The accumulation component on the inception date will equal one. On each subsequent business day until maturity or early redemption, the accumulation component will equal (1) the accumulation component on the immediately preceding business day *times* (2) the sum of one *plus* the product of the deposit rate *times* the relevant daycount fraction.

Table of Contents

The index factor on any given day will be equal to the currency component on that day *times* the accumulation component on that day.

The deposit rate on any given day will be equal to the European Overnight Index Average, as reported on Reuters page EONIA or any successor page on the immediately preceding business day (the "EONIA"), *minus* 0.25%. The deposit rate is intended to represent the actual rate that would be paid by a bank on an overnight deposit of euros.

The daycount fraction on any business day will be the number of calendar days that have elapsed since the immediately preceding business day *divided by* 365.

The investor fee is equal to 0.40% per year *times* the principal amount of your Securities *times* the index factor, calculated on a daily basis in the following manner: The investor fee on the inception date will equal zero. On each subsequent calendar day until maturity or early redemption, the investor fee will increase by an amount equal to (1) 0.40% *times* (2) the principal amount of your Securities *times* (3) the index factor on that day (or, if such day is not a trading day, the index factor on the immediately preceding trading day) *divided by* (4) 365.

A valuation date is each Thursday from May 17, 2007 to May 7, 2037 inclusive or, if such date is not a trading day, the next succeeding trading day.

A redemption date is the third business day following a valuation date (other than the final valuation date). The final redemption date will be the third business day following the valuation date that is immediately prior to the final valuation date.

We will not pay you interest during the term of the Securities.

For a further description of how your payment at maturity will be calculated, see "– How Do the Securities Perform at Maturity? – Hypothetical Examples" below and "Specific Terms of the Securities" in this pricing supplement.

Because the investor fee reduces the amount of your return at maturity or upon redemption, the EUR/USD exchange rate may need to increase significantly in order for you to receive at least the principal amount of your investment at maturity or upon redemption. If the increase in the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) is insufficient to offset the negative effect of the investor fee, or the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) decreases, you will receive less than the principal amount of your investment at maturity or upon redemption.

How Do You Redeem Your Securities?

We plan to apply to list the Securities on the New York Stock Exchange. If our application is approved and an active secondary market in the Securities develops, we expect that investors will purchase and sell the Securities primarily in this secondary market.

To redeem your Securities, you must instruct your broker or other person through whom you hold your Securities to take the following steps:

- deliver a notice of redemption, which is attached as Annex A, to us via email by no later than 11:00 a.m., New York City time, on the business day prior to the applicable valuation date. If we receive your notice by the time specified in the preceding sentence, we will respond by sending you a form of confirmation of redemption, which is attached as Annex B;
- deliver the signed confirmation of redemption to us via facsimile in the specified form by 4:00 p.m., New York City time, on the same day. We or our affiliate must acknowledge receipt in order for your confirmation to be effective;
- instruct your DTC custodian to book a delivery vs. payment trade with respect to your Securities on the valuation date at a price equal to the applicable weekly redemption value, facing Barclays Capital DTC 5101; and
- cause your DTC custodian to deliver the trade as booked for settlement via DTC at or prior to 10:00 a.m., New York City time, on the applicable redemption date (the third business day following the valuation date).

Table of Contents

Different brokerage firms may have different deadlines for accepting instructions from their customers. Accordingly, you should consult the brokerage firm through which you own your interest in the Securities in respect of such deadlines. If we do not receive your notice of redemption by 11:00 a.m., or your confirmation of redemption by 4:00 p.m., on the business day prior to the applicable valuation date, your notice will not be effective and we will not redeem your Securities on the applicable redemption date. Any redemption instructions for which we (or our affiliate) receive a valid confirmation in accordance with the procedures described above will be irrevocable.

What Are Some of the Risks of the Securities?

An investment in the Securities involves risks. Some of these risks are summarized here, but we urge you to read the more detailed explanation of risks in "Risk Factors" in this pricing supplement.

- **Uncertain Principal Repayment** – If the EUR/USD exchange rate decreases or does not increase sufficiently, after accounting for the accumulation component, to offset any negative effect of the investor fee, you may receive less than your original investment in the Securities.
- **Currency Risk** – The return on the Securities is linked to the performance of the EUR/USD exchange rate which, in turn, is linked to the values of the U.S. dollar and the euro. Currency prices may change unpredictably, affecting the EUR/USD exchange rate and, consequently, the value of your Securities in unforeseeable ways.
- **No Interest Payments** – You will not receive any periodic interest payments on the Securities.
- **A Trading Market for the Securities May Not Develop** – Although we plan to apply to list the Securities on the New York Stock Exchange, a trading market for your Securities does not currently exist and may not develop. Certain affiliates of Barclays Bank PLC intend to engage in limited purchase and resale transactions. If they do, however, they are not required to do so and may stop at any time. We are not required to maintain any listing of the Securities on the New York Stock Exchange or any other exchange.

Is This the Right Investment for You?

The Securities may be a suitable investment for you if:

- You are willing to accept the risk of fluctuations in currency prices in general and the EUR/USD exchange rate in particular.
- You believe the value of the euro relative to the U.S. dollar and/or the accumulation component will increase by an amount sufficient to offset any negative effect of the investor fee during the term of the Securities.
- You do not seek current income from this investment.
- You seek an investment with a return linked to the performance of the EUR/USD exchange rate.
- You do not seek a guaranteed return of principal.

The Securities may not be a suitable investment for you if:

- You are not willing to be exposed to fluctuations in currency prices in general and the EUR/USD exchange rate in particular.
- You believe the value of the euro relative to the U.S. dollar will decrease or will not increase by an amount sufficient to offset any negative effect of the investor fee during the term of the Securities, even after accounting for the accumulation component.
- You prefer the lower risk and therefore accept the potentially lower returns of fixed income investments with comparable maturities and credit ratings.
- You seek current income from your investment.
- You seek a guaranteed return of principal.

Table of Contents

What Are the Tax Consequences?

In the opinion of Sullivan & Cromwell LLP, your Securities should be treated for all tax purposes as a pre-paid derivative contract with respect to the EUR/USD exchange rate. The terms of your Securities require you and us (in the absence of a change of law or an administrative determination or judicial ruling to the contrary) to treat your Securities for all tax purposes in accordance with such characterization. If the Securities are so treated, you will generally recognize gain or loss upon the sale, redemption or maturity of your Securities in an amount equal to the difference between the amount you receive at such time and your tax basis in the Securities. It would be reasonable to take the position that you are permitted to elect to treat such gain or loss as capital gain or loss and that no part of the accumulation component should be treated as interest. However, because there is no authority that specifically addresses the tax treatment of your Securities, it is possible that your Securities could be treated for tax purposes in a manner different from that described above in which case you may not be permitted to elect to treat your gain or loss as capital gain or loss and you may be required to treat part of the accumulation component as interest.

The United States federal income tax consequences of your investment in the Securities are uncertain and it is possible that the Internal Revenue Service may assert an alternative treatment. **Because of this uncertainty, we urge you to consult your own tax advisor as to the tax consequences of your investment in the Securities.**

For a more complete discussion of the U.S. federal income tax consequences of your investment in the Securities, see “Supplemental Tax Considerations — Supplemental U.S. Tax Considerations” in this pricing supplement.

What is the Euro?

The euro is the official currency of the member states of the European Economic and Monetary Union (the “European Monetary Union”). It was introduced in January 1999 and replaced the national currencies of the then 11 participating countries. Today, the euro is the official currency of 13 nations including: Germany, Belgium, Greece, Luxembourg, Spain, France, Slovenia, Ireland, Italy, the Netherlands, Austria, Portugal and Finland. Other current and future European Monetary Union countries may adopt the euro as their official currency. We have obtained all information in this pricing supplement relating to the European Monetary Union, the euro and the EUR/USD exchange rate from public sources, without independent verification.

What Does the EUR/USD Exchange Rate Reflect?

The EUR/USD exchange rate is a foreign exchange spot rate that measures the relative values of two currencies, the euro and the U.S. dollar. When the euro appreciates relative to the U.S. dollar, the EUR/USD exchange rate (and the value of the Securities) increases; when the euro depreciates relative to the U.S. dollar, the EUR/USD exchange rate (and the value of the Securities) decreases. The EUR/USD exchange rate is expressed as a rate that reflects the number of U.S. dollars that can be exchanged for one euro in the interbank market for settlement in two days, as reported each day shortly after 10:00 a.m. on Reuters page 1FED or any successor page.

How Do the Securities Perform?

Set forth below is an explanation of the steps necessary to calculate the payment on the Securities at maturity or upon redemption.

Step 1: Calculate the currency component

The currency component on any given day will be equal to the EUR/USD exchange rate on that day (or, if such day is not a trading day, the EUR/USD exchange rate on the immediately preceding trading day) *divided by* the EUR/USD exchange rate on the inception date.

Step 2: Calculate the accumulation component

The accumulation component will be calculated on a daily basis in the following manner: The accumulation component on the inception date will equal one. On each subsequent business day until maturity or early redemption, the accumulation component will equal (1) the accumulation component on the immediately preceding business day *times* (2) the sum of one *plus* the product of the deposit rate times the relevant daycount fraction.

Table of Contents

Step 3: Calculate the index factor

The index factor on any given day will be equal to the currency component on that day *times* the accumulation component on that day.

Step 4: Calculate the investor fee

The investor fee is equal to 0.40% per year *times* the principal amount of your Securities *times* the index factor, calculated on a daily basis in the following manner: The investor fee on the inception date will equal zero. On each subsequent calendar day until maturity or early redemption, the investor fee will increase by an amount equal to (1) 0.40% *times* (2) the principal amount of your Securities *times* (3) the index factor on that day (or, if such day is not a trading day, the index factor on the immediately preceding trading day) *divided by* (4) 365.

Step 5: Calculate the payment

You will receive a cash payment at maturity or upon redemption, as applicable, equal to (1) the principal amount of your Securities *times* (2) the index factor on the applicable valuation date *minus* (3) the investor fee on the applicable valuation date.

Because the investor fee reduces the amount of your return at maturity or upon redemption, the EUR/USD exchange rate may need to increase significantly in order for you to receive at least the principal amount of your investment at maturity or upon redemption. If the increase in the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) is insufficient to offset the negative effect of the investor fee, or the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) decreases, you will receive less than the principal amount of your investment at maturity or upon redemption.

Table of Contents

Hypothetical Examples

The following examples show how the Securities would perform in hypothetical circumstances. We have included two examples in which the EUR/USD exchange rate has decreased by approximately 50% at maturity, as well as two examples in which the EUR/USD exchange rate has increased by approximately 170% at maturity. These examples also highlight the behavior of the accumulation component in different circumstances. Because the accumulation component is a weighted average measure, the absolute level of the accumulation component will be dependent upon the path taken by the deposit rate during the term of the Securities. The figures in these examples have been rounded for convenience. Figures for year end 30 in each example are as of the final valuation date, and given the indicated assumptions, a holder will receive payment in the indicated amount, according to the indicated formula.

Assumptions:

Yearly Fee	Days	Principal	Starting EUR/USD Exchange Rate	Starting Deposit Rate
0.40%	365	$ 50.00	1.356	3.81%

A Year *A*	B EUR/USD Exchange Rate *B*	C Currency Component *B/Starting Exchange Rate*	D Average Deposit Rate *D*	E Average Accumulation Component *Running Total of D*	F Index Factor *C x E*	G Yearly Fee *F x Principal x 0.40%*	H Cumulative Investor Fee *Running Total of G*	I Average Indicative Value *(Principal x F) - H*
0	1.356	1.0000	0.000%	1.0000	100.00%	$ 0.00	$ 0.00	$ 50.00
1	1.425	1.0509	2.246%	1.0225	107.45%	$ 0.21	$ 0.21	$ 53.51
2	1.428	1.0535	2.464%	1.0477	110.37%	$ 0.22	$ 0.44	$ 54.75
3	1.449	1.0689	1.794%	1.0665	114.00%	$ 0.23	$ 0.66	$ 56.33
4	1.307	0.9643	1.470%	1.0821	104.34%	$ 0.21	$ 0.87	$ 51.30
5	1.353	0.9982	1.742%	1.1010	109.90%	$ 0.22	$ 1.09	$ 53.86
6	1.392	1.0269	1.124%	1.1134	114.33%	$ 0.23	$ 1.32	$ 55.85
7	1.287	0.9494	1.065%	1.1252	106.83%	$ 0.21	$ 1.53	$ 51.88
8	1.108	0.8173	0.740%	1.1335	92.64%	$ 0.19	$ 1.72	$ 44.60
9	1.206	0.8898	0.917%	1.1439	101.79%	$ 0.20	$ 1.92	$ 48.97
10	1.170	0.8632	1.271%	1.1585	100.00%	$ 0.20	$ 2.12	$ 47.88
11	1.200	0.8853	0.819%	1.1680	103.40%	$ 0.21	$ 2.33	$ 49.37
12	0.999	0.7368	1.093%	1.1807	86.99%	$ 0.17	$ 2.50	$ 40.99
13	0.979	0.7222	1.061%	1.1933	86.17%	$ 0.17	$ 2.68	$ 40.41
14	0.927	0.6841	1.298%	1.2088	82.69%	$ 0.17	$ 2.84	$ 38.50
15	0.860	0.6348	0.957%	1.2203	77.46%	$ 0.15	$ 3.00	$ 35.73
16	0.759	0.5599	0.884%	1.2311	68.93%	$ 0.14	$ 3.13	$ 31.33
17	0.895	0.6602	0.601%	1.2385	81.77%	$ 0.16	$ 3.30	$ 37.59
18	0.925	0.6822	0.608%	1.2460	85.01%	$ 0.17	$ 3.47	$ 39.04
19	0.945	0.6969	0.895%	1.2572	87.61%	$ 0.18	$ 3.64	$ 40.16
20	0.890	0.6569	0.624%	1.2650	83.09%	$ 0.17	$ 3.81	$ 37.74
21	0.996	0.7346	0.611%	1.2727	93.50%	$ 0.19	$ 4.00	$ 42.75
22	1.061	0.7824	0.525%	1.2794	100.11%	$ 0.20	$ 4.20	$ 45.86
23	0.947	0.6986	0.366%	1.2841	89.70%	$ 0.18	$ 4.38	$ 40.48
24	0.927	0.6836	0.707%	1.2932	88.40%	$ 0.18	$ 4.55	$ 39.65
25	0.949	0.6999	0.687%	1.3021	91.14%	$ 0.18	$ 4.74	$ 40.83
26	0.964	0.7111	0.579%	1.3096	93.13%	$ 0.19	$ 4.92	$ 41.64
27	0.887	0.6546	0.568%	1.3171	86.21%	$ 0.17	$ 5.09	$ 38.01
28	0.801	0.5910	0.976%	1.3299	78.60%	$ 0.16	$ 5.25	$ 34.05
29	0.811	0.5980	1.075%	1.3442	80.39%	$ 0.16	$ 5.41	$ 34.78
30	0.701	0.5170	1.986%	1.3709	70.87%	$ 0.14	$ 5.55	$ 29.88
							Annualized iPath Indicative Value Return	**-1.70%**
							Total Return	**-40.24%**

Table of Contents

Hypothetical Examples

A Year *A*	B EUR/USD Exchange Rate *B*	C Currency Component *B/Starting Exchange Rate*	D Average Deposit Rate *D*	E Average Accumulation Component *Running Total of D*	F Index Factor *C x E*	G Yearly Fee *F x Principal x 0.40%*	H Cumulative Investor Fee *Running Total of G*	I Average Indicative Value *(Principal x F) - H*
0	1.356	1.0000	0.000%	1.0000	100.00%	$ 0.00	$ 0.00	$ 50.00
1	1.425	1.0509	4.108%	1.0411	109.41%	$ 0.22	$ 0.22	$ 54.49
2	1.428	1.0535	5.356%	1.0968	115.55%	$ 0.23	$ 0.45	$ 57.33
3	1.449	1.0689	7.168%	1.1755	125.65%	$ 0.25	$ 0.70	$ 62.12
4	1.307	0.9643	5.956%	1.2455	120.10%	$ 0.24	$ 0.94	$ 59.11
5	1.353	0.9982	5.959%	1.3197	131.73%	$ 0.26	$ 1.20	$ 64.66
6	1.392	1.0269	5.832%	1.3967	143.43%	$ 0.29	$ 1.49	$ 70.22
7	1.287	0.9494	6.745%	1.4909	141.55%	$ 0.28	$ 1.77	$ 69.00
8	1.108	0.8173	7.604%	1.6042	131.11%	$ 0.26	$ 2.04	$ 63.52
9	1.206	0.8898	6.664%	1.7111	152.26%	$ 0.30	$ 2.34	$ 73.79
10	1.170	0.8632	6.540%	1.8230	157.37%	$ 0.31	$ 2.66	$ 76.03
11	1.200	0.8853	6.520%	1.9419	171.92%	$ 0.34	$ 3.00	$ 82.96
12	0.999	0.7368	6.896%	2.0758	152.94%	$ 0.31	$ 3.31	$ 73.16
13	0.979	0.7222	8.357%	2.2493	162.43%	$ 0.32	$ 3.63	$ 77.59
14	0.927	0.6841	8.159%	2.4328	166.42%	$ 0.33	$ 3.96	$ 79.25
15	0.860	0.6348	7.477%	2.6147	165.97%	$ 0.33	$ 4.30	$ 78.69
16	0.759	0.5599	8.508%	2.8372	158.86%	$ 0.32	$ 4.61	$ 74.82
17	0.895	0.6602	10.442%	3.1334	206.88%	$ 0.41	$ 5.03	$ 98.41
18	0.925	0.6822	7.989%	3.3838	230.85%	$ 0.46	$ 5.49	$ 109.94
19	0.945	0.6969	9.145%	3.6932	257.38%	$ 0.51	$ 6.00	$ 122.69
20	0.890	0.6569	11.138%	4.1045	269.61%	$ 0.54	$ 6.54	$ 128.26
21	0.996	0.7346	9.083%	4.4773	328.91%	$ 0.66	$ 7.20	$ 157.25
22	1.061	0.7824	6.386%	4.7632	372.69%	$ 0.75	$ 7.95	$ 178.40
23	0.947	0.6986	7.334%	5.1126	357.15%	$ 0.71	$ 8.66	$ 169.91
24	0.927	0.6836	6.917%	5.4662	373.65%	$ 0.75	$ 9.41	$ 177.42
25	0.949	0.6999	7.556%	5.8793	411.50%	$ 0.82	$ 10.23	$ 195.52
26	0.964	0.7111	6.691%	6.2727	446.06%	$ 0.89	$ 11.12	$ 211.91
27	0.887	0.6546	5.991%	6.6484	435.17%	$ 0.87	$ 11.99	$ 205.59
28	0.801	0.5910	7.215%	7.1281	421.26%	$ 0.84	$ 12.84	$ 197.79
29	0.811	0.5980	6.099%	7.5629	452.29%	$ 0.90	$ 13.74	$ 212.41
30	0.701	0.5170	8.370%	8.1959	423.70%	$ 0.85	$ 14.59	$ 197.26
					Annualized iPath Indicative Value Return			**4.68%**
							Total Return	**294.52%**

Table of Contents

Hypothetical Examples

A Year *A*	B EUR/USD Exchange Rate *B*	C Currency Component *B/Starting Exchange Rate*	D Average Deposit Rate *D*	E Average Accumulation Component *Running Total of D*	F Index Factor *C x E*	G Yearly Fee *F x Principal x 0.40%*	H Cumulative Investor Fee *Running Total of G*	I Average Indicative Value *(Principal x F) - H*
0	1.356	1.0000	0.000%	1.0000	100.00%	$ 0.00	$ 0.00	$ 50.00
1	1.284	0.9472	2.246%	1.0225	96.85%	$ 0.19	$ 0.19	$ 48.23
2	1.311	0.9672	2.464%	1.0477	101.33%	$ 0.20	$ 0.40	$ 50.27
3	1.423	1.0494	1.794%	1.0665	111.92%	$ 0.22	$ 0.62	$ 55.34
4	1.395	1.0293	1.470%	1.0821	111.39%	$ 0.22	$ 0.84	$ 54.85
5	1.538	1.1346	1.742%	1.1010	124.92%	$ 0.25	$ 1.09	$ 61.36
6	1.811	1.3363	1.124%	1.1134	148.77%	$ 0.30	$ 1.39	$ 73.00
7	1.896	1.3983	1.065%	1.1252	157.34%	$ 0.31	$ 1.71	$ 76.96
8	1.822	1.3443	0.740%	1.1335	152.38%	$ 0.30	$ 2.01	$ 74.18
9	1.942	1.4329	0.917%	1.1439	163.92%	$ 0.33	$ 2.34	$ 79.62
10	2.169	1.6004	1.271%	1.1585	185.40%	$ 0.37	$ 2.71	$ 89.99
11	1.916	1.4133	0.819%	1.1680	165.06%	$ 0.33	$ 3.04	$ 79.49
12	2.111	1.5572	1.093%	1.1807	183.86%	$ 0.37	$ 3.41	$ 88.52
13	1.831	1.3503	1.061%	1.1933	161.13%	$ 0.32	$ 3.73	$ 76.84
14	1.741	1.2840	1.298%	1.2088	155.20%	$ 0.31	$ 4.04	$ 73.56
15	1.965	1.4493	0.957%	1.2203	176.86%	$ 0.35	$ 4.39	$ 84.04
16	2.427	1.7906	0.884%	1.2311	220.44%	$ 0.44	$ 4.83	$ 105.38
17	2.435	1.7964	0.601%	1.2385	222.48%	$ 0.44	$ 5.28	$ 105.96
18	2.434	1.7957	0.608%	1.2460	223.74%	$ 0.45	$ 5.73	$ 106.15
19	2.400	1.7702	0.895%	1.2572	222.54%	$ 0.45	$ 6.17	$ 105.10
20	2.495	1.8405	0.624%	1.2650	232.82%	$ 0.47	$ 6.64	$ 109.77
21	2.465	1.8183	0.611%	1.2727	231.42%	$ 0.46	$ 7.10	$ 108.61
22	2.638	1.9462	0.525%	1.2794	249.00%	$ 0.50	$ 7.60	$ 116.90
23	2.849	2.1017	0.366%	1.2841	269.88%	$ 0.54	$ 8.14	$ 126.80
24	2.832	2.0893	0.707%	1.2932	270.19%	$ 0.54	$ 8.68	$ 126.41
25	3.213	2.3703	0.687%	1.3021	308.63%	$ 0.62	$ 9.29	$ 145.02
26	3.471	2.5605	0.579%	1.3096	335.33%	$ 0.67	$ 9.97	$ 157.70
27	3.446	2.5424	0.568%	1.3171	334.85%	$ 0.67	$ 10.64	$ 156.79
28	3.320	2.4489	0.976%	1.3299	325.68%	$ 0.65	$ 11.29	$ 151.55
29	4.070	3.0024	1.075%	1.3442	403.59%	$ 0.81	$ 12.09	$ 189.70
30	3.679	2.7139	1.986%	1.3709	372.06%	$ 0.74	$ 12.84	$ 173.19
							Annualized iPath Indicative Value Return	**4.23%**
							Total Return	**246.38%**

Table of Contents

Hypothetical Examples

A Year *A*	B EUR/USD Exchange Rate *B*	C Currency Component *B/Starting Exchange Rate*	D Average Deposit Rate *D*	E Average Accumulation Component *Running Total of D*	F Index Factor *C x E*	G Yearly Fee *F x Principal x 0.40%*	H Cumulative Investor Fee *Running Total of G*	I Average Indicative Value *(Principal x F) - H*
0	1.356	1.0000	0.000%	1.0000	100.00%	$ 0.00	$ 0.00	$ 50.00
1	1.284	0.9472	4.108%	1.0411	98.62%	$ 0.20	$ 0.20	$ 49.11
2	1.311	0.9672	5.356%	1.0968	106.08%	$ 0.21	$ 0.41	$ 52.63
3	1.423	1.0494	7.168%	1.1755	123.36%	$ 0.25	$ 0.66	$ 61.02
4	1.395	1.0293	5.956%	1.2455	128.20%	$ 0.26	$ 0.91	$ 63.19
5	1.538	1.1346	5.959%	1.3197	149.73%	$ 0.30	$ 1.21	$ 73.65
6	1.811	1.3363	5.832%	1.3967	186.63%	$ 0.37	$ 1.59	$ 91.73
7	1.896	1.3983	6.745%	1.4909	208.47%	$ 0.42	$ 2.00	$ 102.23
8	1.822	1.3443	7.604%	1.6042	215.66%	$ 0.43	$ 2.43	$ 105.39
9	1.942	1.4329	6.664%	1.7111	245.19%	$ 0.49	$ 2.92	$ 119.67
10	2.169	1.6004	6.540%	1.8230	291.76%	$ 0.58	$ 3.51	$ 142.37
11	1.916	1.4133	6.520%	1.9419	274.45%	$ 0.55	$ 4.06	$ 133.17
12	2.111	1.5572	6.896%	2.0758	323.24%	$ 0.65	$ 4.70	$ 156.92
13	1.831	1.3503	8.357%	2.2493	303.73%	$ 0.61	$ 5.31	$ 146.56
14	1.741	1.2840	8.159%	2.4328	312.37%	$ 0.62	$ 5.93	$ 150.25
15	1.965	1.4493	7.477%	2.6147	378.96%	$ 0.76	$ 6.69	$ 182.79
16	2.427	1.7906	8.508%	2.8372	508.01%	$ 1.02	$ 7.71	$ 246.30
17	2.435	1.7964	10.442%	3.1334	562.89%	$ 1.13	$ 8.83	$ 272.61
18	2.434	1.7957	7.989%	3.3838	607.61%	$ 1.22	$ 10.05	$ 293.75
19	2.400	1.7702	9.145%	3.6932	653.75%	$ 1.31	$ 11.36	$ 315.52
20	2.495	1.8405	11.138%	4.1045	755.42%	$ 1.51	$ 12.87	$ 364.84
21	2.465	1.8183	9.083%	4.4773	814.10%	$ 1.63	$ 14.50	$ 392.55
22	2.638	1.9462	6.386%	4.7632	927.01%	$ 1.85	$ 16.35	$ 447.15
23	2.849	2.1017	7.334%	5.1126	1074.50%	$ 2.15	$ 18.50	$ 518.75
24	2.832	2.0893	6.917%	5.4662	1142.06%	$ 2.28	$ 20.78	$ 550.25
25	3.213	2.3703	7.556%	5.8793	1393.54%	$ 2.79	$ 23.57	$ 673.20
26	3.471	2.5605	6.691%	6.2727	1606.13%	$ 3.21	$ 26.78	$ 776.28
27	3.446	2.5424	5.991%	6.6484	1690.30%	$ 3.38	$ 30.16	$ 814.99
28	3.320	2.4489	7.215%	7.1281	1745.59%	$ 3.49	$ 33.65	$ 839.14
29	4.070	3.0024	6.099%	7.5629	2270.69%	$ 4.54	$ 38.20	$ 1,097.15
30	3.679	2.7139	8.370%	8.1959	2224.30%	$ 4.45	$ 42.64	$ 1,069.51
							Annualized iPath Indicative Value Return	**10.75%**
							Total Return	**2039.01%**

Table of Contents

RISK FACTORS

The Securities are unsecured promises of Barclays Bank PLC and are not secured debt. The Securities are riskier than ordinary unsecured debt securities. The return on the Securities is linked to the performance of the EUR/USD exchange rate. Investing in the Securities is not equivalent to investing directly in the U.S. dollar, the euro or other securities or future contracts linked to the EUR/USD exchange rate. See "The Index" below for more information.

This section describes the most significant risks relating to an investment in the Securities. **We urge you to read the following information about these risks, together with the other information in this pricing supplement and the accompanying prospectus and prospectus supplement, before investing in the Securities.**

Even If the Value of the EUR/USD Exchange Rate at Maturity or Upon Redemption Is Greater than It Was on the Inception Date, You May Receive Less than the Principal Amount of Your Securities

Because the investor fee reduces the amount of your return at maturity or upon redemption, the EUR/USD exchange rate may need to increase significantly in order for you to receive at least the principal amount of your investment at maturity or upon redemption. If the increase in the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) is insufficient to offset the negative effect of the investor fee, or the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) decreases, you will receive less than the principal amount of your investment at maturity or upon redemption.

You Will Not Benefit from any Increase in the EUR/USD Exchange Rate if Such Increase Is Not Reflected in the EUR/USD Exchange Rate on the Applicable Valuation Date

If the positive effect of any increase in the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) is insufficient to offset the negative effect of the investor fee between the inception date and the applicable valuation date (including the final valuation date), we will pay you less than the principal amount of your Securities at maturity or upon redemption. This will be true even if the EUR/USD exchange rate (as enhanced or reduced by the accumulation component) as of some date or dates prior to the applicable valuation date would have been sufficiently high to offset the negative effect of the investor fee.

There Are Restrictions on the Minimum Number of Securities You May Redeem and on the Dates on Which You May Redeem Them

You must redeem at least 50,000 Securities at one time in order to exercise your right to redeem your Securities on any redemption date. You may only redeem your Securities on a redemption date if we receive a notice of redemption from you by no later than 11:00 a.m. and a confirmation of redemption by no later than 4:00 p.m. on the business day prior to the applicable valuation date. If we do not receive your notice of redemption by 11:00 a.m., or your confirmation of redemption by 4:00 p.m., on the business day prior to the applicable valuation date, your notice will not be effective and we will not redeem your Securities on the applicable redemption date. Your notice of redemption and confirmation of redemption will not be effective until we confirm receipt. See "Specific Terms of the Securities – Redemption Procedures" for more information. You will have no right to redeem your Securities during the week in which the Securities mature.

The Market Value of the Securities May Be Influenced by Many Unpredictable Factors

The market value of your Securities may fluctuate between the date you purchase them and the applicable valuation date. You may also sustain a significant loss if you sell the Securities in the secondary market. Several factors, many of which are beyond our control, will influence the market value of the Securities. We expect that generally changes in the EUR/USD exchange rate will affect the market value of the Securities more than any other factor. Other factors that may influence the market value of the Securities include:

- the time remaining to the maturity of the Securities;

Table of Contents

- supply and demand for the Securities, including inventory positions with Barclays Capital Inc. or any market maker;
- interest rates, especially the EONIA;
- the volatility of the EUR/USD exchange rate;
- economic, financial, political, regulatory, geographical or judicial events that affect the EUR/USD exchange rate; or
- the creditworthiness of Barclays Bank PLC.

These factors interrelate in complex ways, and the effect of one factor on the market value of your Securities may offset or enhance the effect of another factor.

The EUR/USD Exchange Rate Will be Influenced by Unpredictable Factors

The EUR/USD exchange rate is a result of the supply of, and demand for, each currency. Changes in the EUR/USD exchange rate may result from the interactions of many factors including economic, financial, social and political conditions in Europe and the United States. These conditions include, for example, the overall growth and performance of the economies of the United States and the European Monetary Union, and the constituent nations thereof, the trade and current account balance between the United States and the nations of the European Monetary Union, inflation, interest rate levels, the performance of stock markets in the United States and Europe, the stability of the United States and European governments and banking systems, wars in which the United States or European nations are directly or indirectly involved or that occur anywhere in the world, major natural disasters in the United States or Europe, and other foreseeable and unforeseeable events.

Certain relevant information relating to the European Monetary Union and the constituent nations thereof may not be as well known or as rapidly or thoroughly reported in the United States as compared to U.S. developments. Prospective purchasers of the Securities should be aware of the possible lack of availability of important information that can affect the value of the euro in relation to the U.S. dollar and must be prepared to make special efforts to obtain such information on a timely basis.

The Liquidity, Trading Value and Amounts Payable Under the Securities Could be Affected by the Actions of Sovereign Governments, including the U.S. and European Governments, or of the European Monetary Union

Exchange rates of most developed economies, including the United States and the European Monetary Union, are “floating,” meaning that they are permitted to fluctuate in value relative to other currencies. However, governments of other nations, from time to time, do not allow their currencies to float freely in response to economic forces. Governments, including the U.S. and European governments and the European Monetary Union authorities, use a variety of techniques, such as intervention by their central bank or imposition of regulatory controls or taxes, to affect the exchange rates of their respective currencies. Governments may also issue a new currency to replace an existing currency or alter the exchange rate or relative exchange characteristics by devaluation or revaluation of a currency. Thus, a special risk in purchasing the Securities is that their liquidity, trading value and amounts payable could be affected by the actions of the U.S. or European governments or of the European Monetary Union authorities which could change or interfere with theretofore freely determined currency valuation, fluctuations in response to other market forces and the movement of currencies across borders. There will be no adjustment or change in the terms of the Securities in the event that exchange rates should become fixed, or in the event of any devaluation or revaluation or imposition of exchange or other regulatory controls or taxes, or in the event of the issuance of a replacement currency or in the event of other developments affecting the euro, the U.S. dollar or any other currency.

Even Though the U.S. Dollar and the Euro Are Traded Around-the-Clock, the Securities Will Trade Only During Regular Trading Hours in the United States

The interbank market for the U.S. dollar and the euro is a global, around-the-clock market. We plan to apply to list the Securities on the New York Stock Exchange, and if our application is approved, the Securities will trade only during

Table of Contents

the hours that the New York Stock Exchange is open. To the extent that the New York Stock Exchange is closed while the markets for the U.S. dollar and the euro remain open, significant price and rate movements may take place in the underlying foreign exchange markets that will not be reflected immediately in the price of the Securities.

Foreign Exchange Rate Information May Not Be Readily Available

There is no systematic reporting of last-sale information for foreign currencies. Reasonable current bid and offer information is available in certain brokers' offices, in bank foreign currency trading offices, and to others who wish to subscribe for this information, but this information will not necessarily reflect the EUR/USD exchange rate relevant for determining the value of the Securities. The absence of last-sale information and the limited availability of quotations to individual investors may make it difficult for many investors to obtain timely, accurate data about the state of the underlying foreign exchange markets.

Historical Levels of the EUR/USD Exchange Rate Should Not Be Taken as an Indication of the Future Performance of the EUR/USD Exchange Rate During the Term of the Securities

It is impossible to predict whether the EUR/USD exchange rate will rise or fall. The actual performance of the EUR/USD exchange rate over the term of the Securities, as well as the amount payable at maturity or upon redemption, may bear little relation to the historical level of the EUR/USD exchange rate.

Changes in the EONIA May Affect the Value of Your Securities

Because the value of the Securities is linked, in part, to the EONIA, changes in that rate will affect the amount payable on your Securities at maturity or upon redemption and, therefore, the market value of your Securities. Assuming the level of the EUR/USD exchange rate remains constant, an increase in the EONIA will increase the value of your Securities, while a decrease in the rate will decrease the value of your Securities.

Changes in Our Credit Ratings May Affect the Market Value of Your Securities

Our credit ratings are an assessment of our ability to pay our obligations, including those on the Securities. Consequently, actual or anticipated changes in our credit ratings may affect the market value of your Securities. However, because the return on your Securities is dependent upon certain factors in addition to our ability to pay our obligations on your Securities, an improvement in our credit ratings will not reduce the other investment risks related to your Securities.

Owning the Securities Is Not the Same as Owning Euros

The return on your Securities will not reflect the return you would realize if you actually purchased euros and converted them into U.S. dollars on the applicable valuation date. The EUR/USD exchange rate is calculated by reference to the euro relative to the U.S. dollar without taking into consideration the value of the euro relative to other currencies or in other markets.

You Will Not Receive Interest Payments on the Securities or Have the Right to Receive Euros

You will not receive any periodic interest payments on the Securities. Your Securities will be paid in U.S. dollars, and you will have no right to receive delivery of euros.

There May Not Be an Active Trading Market in the Securities; Sales in the Secondary Market May Result in Significant Losses

Although we plan to apply to list the Securities on the New York Stock Exchange, there can be no assurance that our application will be approved or that a secondary market for the Securities will develop. Certain affiliates of Barclays Bank PLC may engage in limited purchase and resale transactions in the Securities, although they are not required to do so. If they decide to engage in such transactions, they may stop at any time. We are not required to maintain any listing of the Securities on the New York Stock Exchange or any other exchange.

Table of Contents

Trading and Other Transactions by Barclays Bank PLC or Its Affiliates in Instruments Linked to the U.S. Dollar, the Euro or the EUR/USD Exchange Rate May Impair the Market Value of the Securities

As described below under "Use of Proceeds and Hedging" in this pricing supplement, we or one or more of our affiliates may hedge our obligations under the Securities by purchasing U.S. dollars or euros, futures or options on U.S. dollars or euros or the EUR/USD exchange rate, or other derivative instruments with returns linked to the performance of the U.S. dollar or the euro or the EUR/USD exchange rate, and we may adjust these hedges by, among other things, purchasing or selling any of the foregoing. Although they are not expected to, any of these hedging activities may adversely affect the market price of the U.S. dollar or the euro and the EUR/USD exchange rate and, therefore, the market value of the Securities. It is possible that we or one or more of our affiliates could receive substantial returns from these hedging activities while the market value of the Securities declines.

We or one or more of our affiliates may also engage in trading in U.S. dollars or euros, futures or options on U.S dollars or euros, and other investments relating to the U.S. dollar or the euro or the EUR/USD exchange rate on a regular basis as part of our general broker-dealer and other businesses, for proprietary accounts, for other accounts under management or to facilitate transactions for customers. Any of these activities could adversely affect the market price of the U.S. dollar or the euro or the level of the EUR/USD exchange rate and, therefore, the market value of the Securities. We or one or more of our affiliates may also issue or underwrite other securities or financial or derivative instruments with returns linked or related to changes in the performance of any of the foregoing. By introducing competing products into the marketplace in this manner, we or one or more of our affiliates could adversely affect the market value of the Securities. With respect to any of the activities described above, neither Barclays Bank PLC nor its affiliates has any obligation to take the needs of any buyer, seller or holder of the Securities into consideration at any time.

The Liquidity of the Market for the Securities May Vary Materially Over Time

As stated on the cover of this pricing supplement, we intend to sell a portion of the Securities on the inception date, and the remainder of the Securities will be offered and sold from time to time through Barclays Capital Inc., our affiliate, as agent. Also, the number of Securities outstanding or held by persons other than our affiliates could be reduced at any time due to early redemptions of the Securities. Accordingly, the liquidity of the market for the Securities could vary materially over the term of the Securities. While you may elect to redeem your Securities prior to maturity, early redemption is subject to the conditions and procedures described elsewhere in this pricing supplement, including the condition that you must redeem at least 50,000 Securities at one time in order to exercise your right to redeem your Securities on any redemption date.

Our Business Activities May Create Conflicts of Interest

We and our affiliates expect to play a variety of roles in connection with the issuance of the Securities. As noted above, we and our affiliates expect to engage in trading activities related to U.S. dollars or euros , futures or options on U.S. dollars or euros or the EUR/USD exchange rate, or other derivative instruments with returns linked to the performance of the U.S. dollar or the euro or the EUR/USD exchange rate that are not for the account of holders of the Securities or on their behalf. These trading activities may present a conflict between the holders' interest in the Securities and the interests that we and our affiliates will have in our and our affiliates' proprietary accounts, in facilitating transactions, including options and other derivatives transactions, for our and our affiliates' customers and in accounts under our and our affiliates' management. These trading activities, if they influence the EUR/USD exchange rate, could be adverse to the interests of the holders of the Securities. Moreover, we and our affiliates have published and in the future expect to publish research reports with respect to the EUR/USD exchange rate and currencies generally. This research is modified from time to time without notice and may express opinions or provide recommendations that are inconsistent with

Table of Contents

purchasing or holding the Securities. The research should not be viewed as a recommendation or endorsement of the Securities in any way and investors must make their own independent investigation of the merits of this investment. Any of these activities by us, Barclays Capital Inc. or our other affiliates may affect the market price of the U.S. dollar or the euro and the EUR/USD exchange rate and, therefore, the market value of the Securities. With respect to any of the activities described above, neither Barclays Bank PLC nor its affiliates has any obligation to take the needs of any buyer, seller or holder of the Securities into consideration at any time.

There Are Potential Conflicts of Interest Between You and the Calculation Agent

Initially, Barclays Bank PLC will serve as the calculation agent. We will, among other things, decide the amount of the return paid out to you on the Securities at maturity or upon redemption. For a more detailed description of the calculation agent's role, see "Specific Terms of the Securities – Role of Calculation Agent" in this pricing supplement.

THE INDEX

We have obtained all information about the EUR/USD exchange rate from public sources, without independent verification.

The EUR/USD exchange rate is a foreign exchange spot rate that measures the relative values of two currencies, the euro and the U.S. dollar. When the euro appreciates relative to the U.S. dollar, the EUR/USD exchange rate (and the value of the Securities) increases; when the euro depreciates relative to the U.S. dollar, the EUR/USD exchange rate (and the value of the Securities) decreases. The EUR/USD exchange rate is expressed as a rate that reflects the number of U.S. dollars that can be exchanged for one euro in the interbank market for settlement in two days, as reported each day shortly after 10:00 a.m. on Reuters page 1FED or any successor page.

U.S. dollars and euros are traded by all major foreign exchange traders around the world. The following table presents the level of the EUR/USD exchange rate at the end of each month since January 2000. We obtained the information set forth below from the Federal Reserve Bank of New York without independent verification. You should not take the historical EUR/USD exchange rate as an indication of future performance.

January 31, 2000	0.9796
February 29, 2000	0.9674
March 31, 2000	0.9576
April 28, 2000	0.9098
May 31, 2000	0.9329
June 30, 2000	0.9585
July 31, 2000	0.9267
August 31, 2000	0.8898
September 29, 2000	0.8792
October 31, 2000	0.8476
November 30, 2000	0.8693
December 29, 2000	0.9307
January 31, 2001	0.9321
February 28, 2001	0.9207
March 30, 2001	0.8851
April 30, 2001	0.8871
May 31, 2001	0.8473
June 29, 2001	0.8473
July 31, 2001	0.8756
August 31, 2001	0.9152
September 28, 2001	0.9134
October 31, 2001	0.9014
November 30, 2001	0.8951
December 31, 2001	0.8911
January 31, 2002	0.8616
February 28, 2002	0.8635
March 29, 2002	0.8716
April 30, 2002	0.9024
May 31, 2002	0.9364
June 28, 2002	0.9925

July 31, 2002	0.9777
August 30, 2002	0.9850
September 30, 2002	0.9880
October 31, 2002	0.9893
November 29, 2002	0.9944
December 31, 2002	1.0476
January 31, 2003	1.0758
February 28, 2003	1.0791
March 31, 2003	1.0912
April 30, 2003	1.1142
May 30, 2003	1.1803
June 30, 2003	1.1454
July 31, 2003	1.1271

Table of Contents

August 29, 2003	1.0956
September 30, 2003	1.1707
October 31, 2003	1.1618
November 28, 2003	1.2009
December 31, 2003	1.2623
January 30, 2004	1.2408
February 27, 2004	1.2477
March 31, 2004	1.2290
April 30, 2004	1.1989
May 28, 2004	1.2252
June 30, 2004	1.2171
July 30, 2004	1.2094
August 31, 2004	1.2117
September 30, 2004	1.2401
October 29, 2004	1.2740
November 30, 2004	1.3310
December 31, 2004	1.3626
January 31, 2005	1.3036
February 28, 2005	1.3248
March 31, 2005	1.3004
April 29, 2005	1.2936
May 31, 2005	1.2351
June 30, 2005	1.2082
July 29, 2005	1.2132
August 31, 2005	1.2228
September 30, 2005	1.2031
October 31, 2005	1.2005
November 30, 2005	1.1768
December 30, 2005	1.1801
January 31, 2006	1.2124
February 28, 2006	1.1886
March 31, 2006	1.2102
April 28, 2006	1.2569
May 31, 2006	1.2854
June 30, 2006	1.2768
July 31, 2006	1.2764
August 31, 2006	1.2838
September 29, 2006	1.2658
October 31, 2006	1.2720
November 30, 2006	1.3212
December 29, 2006	1.3184
January 31, 2007	1.2963
February 28, 2007	1.3210
March 30, 2007	1.3309
April 30, 2007	1.3640

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

Table of Contents

The following graph illustrates the hypothetical performance of the index factor over the period from January 1, 1999 to April 30, 2007, as if the inception date had been January 1, 1999. The graph uses data for the EUR/USD exchange rate and the EONIA for that period. As described in this pricing supplement, the index factor on any given day will be equal to the currency component on that day *times* the accumulation component on that day. The hypothetical performance of the index factor in the following graph should be not interpreted as an indication of the actual or expected performance of the index factor for purposes of the Securities. Moreover, the performance of the index factor alone does not reflect the effect of the investor fee, which will reduce the value of the Securities.

Hypothetical Performance of the Index Factor
01/01/99 - 04/30/07

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

VALUATION OF THE SECURITIES

The market value of the Securities will be affected by several factors, many of which are beyond our control. We expect that generally changes in the EUR/USD exchange rate will affect the market value of the Securities more than any other factors. Other factors that may influence the market value of the Securities include, but are not limited to, supply and demand for the Securities, interest rates (including especially the EONIA), economic, financial, political, regulatory, geographical or judicial events that affect the EUR/USD exchange rate as well as the perceived creditworthiness of Barclays Bank PLC. See “Risk Factors” in this pricing supplement for a discussion of the factors that may influence the market value of the Securities prior to maturity.

Indicative Value

We or an affiliate expect to calculate and publish the closing “indicative value” of your Securities on each trading day at www.ipathetn.com. In connection with your Securities, we use the term “indicative value” to refer to the value at a given time determined based on the following equation:

Table of Contents

Indicative Value = Principal Amount x (Current Currency Component x Current Accumulation Component) - Current Investor Fee

where:

Principal Amount per Security = $50;

Current Currency Component = The most recent daily calculation of the currency component, determined as described in this pricing supplement;

Current Accumulation Component = The most recent daily calculation of the accumulation component, determined as described in this pricing supplement; and

Current Investor Fee = The most recent daily calculation of the investor fee with respect to your Securities, determined as described in this pricing supplement.

Additionally, an "intraday" indicative value meant to approximate the intrinsic economic value of the securities will be calculated and published by Bloomberg L.P. or a successor via the facilities of the Consolidated Tape Association under the ticker symbol ERO.IV. For purposes of calculating this intraday indicative value, Bloomberg L.P. or a successor will use appropriate market data (for example, an average of live exchange rate from major financial institutions and market participants) available during the day to approximate the Index.

Bloomberg L.P. is not affiliated with Barclays Bank PLC and does not approve, endorse, review or recommend Barclays Bank PLC or the Securities.

The indicative value will be derived from sources deemed reliable, but Bloomberg L.P. and its suppliers do not guarantee the correctness or completeness of the indicative value or other information furnished in connection with the Securities. Bloomberg L.P. makes no warranty, express or implied, as to results to be obtained by Barclays Bank PLC, Barclays Bank PLC's customers, holders of the Securities, or any other person or entity from the use of the indicative value or any data included therein. Bloomberg L.P. makes no express or implied warranties, and expressly disclaims all warranties of merchantability or fitness for a particular purpose with respect to the indicative value or any data included therein.

Bloomberg L.P., its employees, subcontractors, agents, suppliers and vendors shall have no liability or responsibility, contingent or otherwise, for any injury or damages, whether caused by the negligence of Bloomberg L.P., its employees, subcontractors, agents, suppliers or vendors or otherwise, arising in connection with the indicative value or the Securities, and shall not be liable for any lost profits, losses, punitive, incidental or consequential damages. Bloomberg L.P. shall not be responsible for or have any liability for any injuries or damages caused by errors, inaccuracies, omissions or any other failure in, or delays or interruptions of, the indicative value, from whatever cause. Bloomberg L.P. is not responsible for the selection of or use of the Index or the Securities, the accuracy and adequacy of Index or information used by Barclays Bank PLC and the resultant output thereof.

The indicative value calculation will be provided for reference purposes only. It is not intended as a price or quotation, or as an offer or solicitation for the purchase, sale, redemption or termination of your Securities, nor will it reflect hedging or transaction costs, credit considerations, market liquidity or bid-offer spreads. Published quotations of the EUR/USD exchange rate from Reuters may occasionally be subject to delay or postponement. Any such delays or postponements will affect the current EUR/USD exchange rate and therefore the indicative value of your Securities. The actual trading price of the Securities may be different from their indicative value.

As discussed in "Specific Terms of the Securities – Payment Upon Redemption", you may, subject to certain restrictions, choose to redeem your Securities on any redemption date during the term of the Securities. If you redeem your Securities on a particular redemption date, you will receive a cash payment on such date in an amount equal to the weekly redemption value, which is (1) the principal amount of your Securities *times* (2) the index factor on the applicable valuation date *minus* (3) the investor fee on the applicable valuation date. You must redeem at least 50,000 Securities at one time in order to exercise your right to redeem your

Table of Contents

Securities on any redemption date. The weekly redemption value is intended to induce arbitrageurs to counteract any trading of the Securities at a premium or discount to their indicative value, though there can be no assurance that arbitrageurs will employ the redemption feature in this manner.

SPECIFIC TERMS OF THE SECURITIES

In this section, references to "holders" mean those who own the Securities registered in their own names, on the books that we or the trustee maintain for this purpose, and not those who own beneficial interests in the Securities registered in street name or in the Securities issued in book-entry form through The Depository Trust Company or another depositary. Owners of beneficial interests in the Securities should read the section entitled "Description of Debt Securities – Legal Ownership; Form of Debt Securities" in the accompanying prospectus.

The Securities are part of a series of debt securities entitled "Medium-Term Notes, Series A" (the "medium-term notes") that we may issue under the indenture, dated September 16, 2004, between Barclays Bank PLC and The Bank of New York, as trustee, from time to time. This pricing supplement summarizes specific financial and other terms that apply to the Securities. Terms that apply generally to all medium-term notes are described in "Description of Medium-Term Notes" and "Terms of the Notes" in the accompanying prospectus supplement, and terms that apply generally to all currency-linked notes are described in "Reference Assets – Currency Exchange Rates" in the accompanying prospectus supplement. The terms described here (i.e., in this pricing supplement) supplement those described in the accompanying prospectus, prospectus supplement and any related free writing prospectuses and, if the terms described here are inconsistent with those described in those documents, the terms described here are controlling.

Please note that the information about the price to the public and the proceeds to Barclays Bank PLC on the front cover of this pricing supplement relates only to the initial sale of the Securities. If you have purchased the Securities in a market-making transaction after the initial sale, information about the price and date of sale to you will be provided in a separate confirmation of sale.

We describe the terms of the Securities in more detail below.

Coupon

We will not pay you interest during the term of the Securities.

Denomination

We will offer the Securities in denominations of $50.

Payment at Maturity

If you hold your Securities to maturity, you will receive a cash payment at maturity that is linked to the percentage change in the EUR/USD exchange rate between the inception date and the final valuation date. Your cash payment at maturity will be equal to (1) the principal amount of your Securities *times* (2) the index factor on the final valuation date *minus* (3) the investor fee on the final valuation date.

The currency component on any given day will be equal to the EUR/USD exchange rate on that day (or, if such day is not a trading day, the EUR/USD exchange rate on the immediately preceding trading day) *divided by* the EUR/USD exchange rate on the inception date.

The accumulation component will be calculated on a daily basis in the following manner: The accumulation component on the inception date will equal one. On each subsequent business day until maturity or early redemption, the accumulation component will equal (1) the accumulation component on the immediately preceding business day *times* (2) the sum of one *plus* the product of the deposit rate *times* the relevant daycount fraction.

The index factor on any given day will be equal to the currency component on that day *times* the accumulation component on that day.

The deposit rate on any given day is the EONIA *minus* 0.25%. The deposit rate is intended to represent the actual rate that would be paid by a bank on an overnight deposit of euros.

Table of Contents

The daycount fraction on any business day will be the number of calendar days that have elapsed since the immediately preceding business day *divided by* 365.

The investor fee is equal to 0.40% per year *times* the principal amount of your Securities *times* the index factor, calculated on a daily basis in the following manner: The investor fee on the inception date will equal zero. On each subsequent calendar day until maturity or early redemption, the investor fee will increase by an amount equal to (1) 0.40% *times* (2) the principal amount of your Securities *times* (3) the index factor on that day (or, if such day is not a trading day, the index factor on the immediately preceding trading day) *divided by* (4) 365.

Maturity Date

If the maturity date stated on the cover of this pricing supplement is not a business day, the maturity date will be the next following business day. If the fifth business day before this day does not qualify as a valuation date (as described below), then the maturity date will be the fifth business day following the final valuation date.

In the event that payment at maturity is deferred beyond the stated maturity date, penalty interest will not accrue or be payable with respect to that deferred payment.

Payment Upon Redemption

Prior to maturity, you may, subject to certain restrictions, choose to redeem your Securities on any redemption date during the term of the Securities. If you redeem your Securities on a particular redemption date, you will receive a cash payment on such date in an amount equal to the weekly redemption value, which equals (1) the principal amount of your Securities *times* (2) the index factor on the applicable valuation date *minus* (3) the investor fee on the applicable valuation date. You must redeem at least 50,000 Securities at one time in order to exercise your right to redeem your Securities on any redemption date. We may from time to time in our sole discretion reduce, in part or in whole, the minimum redemption amount of 50,000 Securities. Any such reduction will be applied on a consistent basis for all holders of Securities at the time the reduction becomes effective.

A valuation date is each Thursday from May 17, 2007 to May 7, 2037 inclusive or, if such date is not a trading day, the next succeeding trading day.

A redemption date is the third business day following a valuation date (other than the final valuation date). The final redemption date will be the third business day following the valuation date immediately prior to the final valuation date.

In the event that payment upon redemption is deferred beyond the original redemption date, penalty interest will not accrue or be payable with respect to that deferred payment.

Redemption Procedures

You may, subject to the minimum redemption amount described above, elect to redeem your Securities on any redemption date. To redeem your Securities, you must instruct your broker or other person with whom you hold your Securities to take the following steps:

- deliver a notice of redemption, which is attached as Annex A, to us via email by no later than 11:00 a.m., New York City time, on the business day prior to the applicable valuation date. If we receive your notice by the time specified in the preceding sentence, we will respond by sending you a form of confirmation of redemption, which is attached as Annex B;
- deliver the signed confirmation of redemption to us via facsimile in the specified form by 4:00 p.m., New York City time, on the same day. We or our affiliate must acknowledge receipt in order for your confirmation to be effective;
- instruct your DTC custodian to book a delivery vs. payment trade with respect to your Securities on the valuation date at a price equal to the applicable weekly redemption value, facing Barclays Capital DTC 5101; and
- cause your DTC custodian to deliver the trade as booked for settlement via DTC at or prior to 10:00 a.m., New York City time, on the applicable redemption date (the third business day following the valuation date).

Table of Contents

Different brokerage firms may have different deadlines for accepting instructions from their customers. Accordingly, you should consult the brokerage firm through which you own your interest in the Securities in respect of such deadlines. If we do not receive your notice of redemption by 11:00 a.m., or your confirmation of redemption by 4:00 p.m., on the business day prior to the applicable valuation date, your notice will not be effective and we will not redeem your Securities on the applicable redemption date. Any redemption instructions for which we (or our affiliate) receive a valid confirmation in accordance with the procedures described above will be irrevocable.

Default Amount on Acceleration

If an event of default occurs and the maturity of the Securities is accelerated, we will pay the default amount in respect of the principal of the Securities at maturity. We describe the default amount below under "– Default Amount".

For the purpose of determining whether the holders of our medium-term notes, of which the Securities are a part, are entitled to take any action under the indenture, we will treat the stated principal amount of each Security outstanding as the principal amount of that Security. Although the terms of the Securities may differ from those of the other medium-term notes, holders of specified percentages in principal amount of all medium-term notes, together in some cases with other series of our debt securities, will be able to take action affecting all the medium-term notes, including the Securities. This action may involve changing some of the terms that apply to the medium-term notes, accelerating the maturity of the medium-term notes after a default or waiving some of our obligations under the indenture. We discuss these matters in the attached prospectus under "Description of Debt Securities – Modification and Waiver" and "– Senior Events of Default; Subordinated Events of Default and Defaults; Limitations of Remedies".

Default Amount

The default amount for the Securities on any day will be an amount, determined by the calculation agent in its sole discretion, equal to the cost of having a qualified financial institution, of the kind and selected as described below, expressly assume all our payment and other obligations with respect to the Securities as of that day and as if no default or acceleration had occurred, or to undertake other obligations providing substantially equivalent economic value to you with respect to the Securities. That cost will equal:

- the lowest amount that a qualified financial institution would charge to effect this assumption or undertaking, plus
- the reasonable expenses, including reasonable attorneys' fees, incurred by the holders of the Securities in preparing any documentation necessary for this assumption or undertaking.

During the default quotation period for the Securities, which we describe below, the holders of the Securities and/or we may request a qualified financial institution to provide a quotation of the amount it would charge to effect this assumption or undertaking. If either party obtains a quotation, it must notify the other party in writing of the quotation. The amount referred to in the first bullet point above will equal the lowest – or, if there is only one, the only – quotation obtained, and as to which notice is so given, during the default quotation period. With respect to any quotation, however, the party not obtaining the quotation may object, on reasonable and significant grounds, to the assumption or undertaking by the qualified financial institution providing the quotation and notify the other party in writing of those grounds within two business days after the last day of the default quotation period, in which case that quotation will be disregarded in determining the default amount.

Default Quotation Period

The default quotation period is the period beginning on the day the default amount first becomes due and ending on the third business day after that day, unless:

- no quotation of the kind referred to above is obtained, or
- every quotation of that kind obtained is objected to within five business days after the due date as described above.

If either of these two events occurs, the default quotation period will continue until the third business day after the first business day on which prompt notice of a quotation is given as

Table of Contents

described above. If that quotation is objected to as described above within five business days after that first business day, however, the default quotation period will continue as described in the prior sentence and this sentence.

In any event, if the default quotation period and the subsequent two business day objection period have not ended before the final valuation date, then the default amount will equal the principal amount of the Securities.

Qualified Financial Institutions

For the purpose of determining the default amount at any time, a qualified financial institution must be a financial institution organized under the laws of any jurisdiction in the United States of America or Europe, which at that time has outstanding debt obligations with a stated maturity of one year or less from the date of issue and rated either:

- A-1 or higher by Standard & Poor's, a division of the McGraw-Hill Companies, Inc., or any successor, or any other comparable rating then used by that rating agency, or
- P-1 or higher by Moody's Investors Service, Inc. or any successor, or any other comparable rating then used by that rating agency.

Further Issuances

We may, without your consent, create and issue additional securities having the same terms and conditions as the Securities. If there is substantial demand for the Securities, we may issue additional Securities frequently. We may consolidate the additional securities to form a single class with the outstanding Securities.

Manner of Payment and Delivery

Any payment on or delivery of the Securities at maturity will be made to accounts designated by you and approved by us, or at the office of the trustee in New York City, but only when the Securities are surrendered to the trustee at that office. We also may make any payment or delivery in accordance with the applicable procedures of the depositary.

Business Day

When we refer to a business day with respect to the Securities, we mean a Monday, Tuesday, Wednesday, Thursday or Friday that is not a day on which banking institutions in London or New York City generally are authorized or obligated by law, regulation or executive order to close.

Role of Calculation Agent

Initially, we will serve as the calculation agent. We may change the calculation agent after the original issue date of the Securities without notice. The calculation agent will, in its sole discretion, make all determinations regarding the value of the Securities, including at maturity or upon redemption, business days, trading days, the index factor, the accumulation component, the default amount, the EUR/USD exchange rate on the inception date and on any valuation date, the currency component, the deposit rate, the EONIA, the investor fee, the maturity date, redemption dates, the amount payable in respect of your Securities at maturity or upon redemption and any other calculations or determinations to be made by the calculation agent as specified herein. Absent manifest error, all determinations of the calculation agent will be final and binding on you and us, without any liability on the part of the calculation agent. You will not be entitled to any compensation from us for any loss suffered as a result of any of the above determinations by the calculation agent.

CLEARANCE AND SETTLEMENT

Depository Trust Company ("DTC") participants that hold the Securities through DTC on behalf of investors will follow the settlement practices applicable to equity securities in DTC's settlement system with respect to the primary distribution of the Securities and secondary market trading between DTC participants.

USE OF PROCEEDS AND HEDGING

We will use the net proceeds we receive from the sale of the Securities for the purposes we describe in the attached prospectus supplement under "Use of Proceeds." We or our affiliates may also use those proceeds in transactions intended to hedge our obligations under the

Securities as described below.

Table of Contents

In anticipation of the sale of the Securities, we or our affiliates expect to enter into hedging transactions involving purchases of U.S. dollars or euros or instruments linked to the U.S. dollar, the euro or the EUR/USD exchange rate prior to or on the inception date. In addition, from time to time after we issue the Securities, we or our affiliates may enter into additional hedging transactions or unwind those hedging transactions we have entered into. In this regard, we or our affiliates may:

- acquire or dispose of long or short positions in listed or over-the-counter options, futures, or other instruments linked to the U.S. dollar or the euro or the EUR/USD exchange rate;
- acquire or dispose of long or short positions in listed or over-the-counter options, futures, or other instruments linked to other similar exchange rates or currencies; or
- any combination of the above two.

We or our affiliates may acquire a long or short position in securities similar to the Securities from time to time and may, in our or their sole discretion, hold or resell those securities.

We or our affiliates may close out our or their hedge positions on or before the final valuation date. That step may involve sales or purchases of listed or over-the-counter options or futures on the U.S. dollar or the euro or listed or over-the-counter options, futures, or other instruments linked to the U.S. dollar or the euro or the EUR/USD exchange rate, as well as other instruments designed to track the performance of the EUR/USD exchange rate or other currencies.

The hedging activity discussed above may have a positive effect on the EUR/USD exchange rate and, as a consequence, a negative effect on the market value of the Securities from time to time and the amount payable at maturity or upon redemption. See “Risk Factors” in this pricing supplement for a discussion of possible adverse effects related to our hedging activities.

SUPPLEMENTAL TAX CONSIDERATIONS

The following is a general description of certain United States tax considerations relating to the Securities. It does not purport to be a complete analysis of all tax considerations relating to the Securities. Prospective purchasers of the Securities should consult their tax advisors as to the consequences under the tax laws of the country of which they are resident for tax purposes and the tax laws of the United Kingdom and the United States of acquiring, holding and disposing of the Securities and receiving payments of interest, principal and/or other amounts under the Securities. This summary is based upon the law as in effect on the date of this pricing supplement and is subject to any change in law that may take effect after such date.

Supplemental U.S. Tax Considerations

The following section supplements the discussion of U.S. federal income taxation in the accompanying prospectus supplement and prospectus. The following section is the opinion of Sullivan & Cromwell LLP, counsel to Barclays Bank PLC. It applies to you only if you are a U.S. holder (as defined below), you acquire your Security in the offering at the offering price and you hold your Security as a capital asset for tax purposes. This section does not apply to you if you are a member of a class of holders subject to special rules, such as:

- a dealer in securities or currencies;
- a trader in securities that elects to use a mark-to-market method of accounting for your securities holdings;
- a bank;
- a life insurance company;
- a tax-exempt organization;
- a regulated investment company;
- a partnership or other pass-through entity;
- a person that owns a note as a hedge or that is hedged against interest rate risks;
- a person that owns a note as part of a straddle or conversion transaction for tax purposes; or
- a U.S. holder (as defined below) whose functional currency for tax purposes is not the U.S. dollar.

Table of Contents

This section is based on the U.S. Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations under the Internal Revenue Code, published rulings and court decisions, all as currently in effect. These laws are subject to change, possibly on a retroactive basis.

You should consult your tax advisor concerning the U.S. federal income tax and other tax consequences of your investment in the Securities in your particular circumstances, including the application of state, local or other tax laws and the possible effects of changes in federal or other tax laws.

This section describes the tax consequences to a U.S. holder. You are a U.S. holder if you are a beneficial owner of a Security and you are for U.S. federal income tax purposes:

- a citizen or resident of the United States;
- a domestic corporation;
- an estate whose income is subject to United States federal income tax regardless of its source; or
- a trust if a United States court can exercise primary supervision over the trust's administration and one or more United States persons are authorized to control all substantial decisions of the trust.

In the opinion of our counsel, Sullivan & Cromwell LLP, the Securities should be treated as a pre-paid derivative contract with respect to the EUR/USD exchange rate. The terms of the Securities require you and us (in the absence of a change of law or an administrative determination or judicial ruling to the contrary) to treat the Securities for all tax purposes in accordance with such characterization. If the Securities are so treated, you will generally recognize gain or loss upon the sale, redemption or maturity of your Securities in an amount equal to the difference between the amount you receive at such time and your tax basis in the Securities. In general, your tax basis in your Securities will be equal to the price you paid for it. The gain or loss would be ordinary gain or loss unless you make the election described below.

In the opinion of our counsel, Sullivan & Cromwell LLP, it would be reasonable to take the position that you are permitted to elect to treat the gain or loss that you recognize with respect to your Securities as capital gain or loss and that no part of the accumulation component should be treated as interest. More specifically a taxpayer may elect to treat the gain or loss from a "forward contract" with respect to foreign currency as capital gain or loss. It would be reasonable to take the position that the Securities should be treated as a "forward contract" for this purpose. Capital gain of a noncorporate United States holder that is recognized in a taxable year beginning before January 1, 2011 is generally taxed at a maximum rate of 15% where the property is held for more than one year.

You may make an election as described above by clearly identifying your Securities as subject to such election in your books and records on the date you acquire your Securities. A sample statement to be included in your books and records in order to make such election is attached in Annex C to this pricing supplement under the heading "Statement to be Included in Books and Records". You must further verify your election by attaching a statement to your income tax return which must (i) set forth a description and date of the election, (ii) state that the election was entered into before the close of the date that you acquired your Securities, (iii) describe any security for which this election was in effect on the date such security was exercised, sold or exchanged during the taxable year, (iv) state that your Securities were never part of a "straddle" as defined in Section 1092 of the Code and (v) state that all transactions subject to the election are included on the statement. A sample statement verifying such election is attached in Annex C to this pricing supplement under the heading "Statement to be Included With Federal Income Tax Return". Alternatively, you will be treated as having satisfied the election and verification requirements if you acquire, hold and dispose of your Securities in an account with an unrelated broker or dealer and the following requirements are met: (i) only transactions entered into on or after the date the account was established may be recorded in the account, (ii) transactions involving the Securities are entered into the account on the date the transactions are entered into and (iii) the broker or dealer provides you with a statement detailing the transactions conducted through the account and includes in

Table of Contents

such statement the following language: “Each transaction identified in this account is subject to the election set forth in section 988(a)(1)(B).” Your election may not be effective if you do not comply with the election and verification requirements.

No statutory, judicial or administrative authority directly discusses how your Securities should be treated for United States federal income tax purposes. As a result, the United States federal income tax consequences of your investment in the Securities are uncertain and alternative characterizations are possible. Accordingly, we urge you to consult your tax advisor in determining the tax consequences of an investment in your Securities in your particular circumstances, including the application of state, local or other tax laws and the possible effects of changes in federal or other tax laws.

Alternative Treatments. Alternative treatments would also be possible and the Internal Revenue Service might assert that treatment other than that described above is more appropriate. For example, it would be possible to treat your Security, and the Internal Revenue Service might assert that your Security should be treated, as a debt instrument subject to the special tax rules governing contingent debt instruments. If the Securities are so treated, you would be required to accrue interest income over the term of your Securities based upon the yield at which we would issue a non-contingent fixed-rate debt instrument with other terms and conditions similar to your Securities. You would recognize gain or loss upon the sale, redemption or maturity of your Securities in an amount equal to the difference, if any, between the amount you receive at such time and your adjusted basis in your Securities. In general, your adjusted basis in your Securities would be equal to the amount you paid for your Securities, increased by the amount of interest you previously accrued with respect to your Securities. Any gain you recognize upon the sale, redemption or maturity of your Securities would be ordinary income and any loss recognized by you at such time would be ordinary loss to the extent of interest you included in income in the current or previous taxable years in respect of your Securities, and thereafter, would be capital loss.

If the Securities are treated as a contingent debt instrument and you purchase your Securities in the secondary market at a price that is at a discount from, or in excess of, the adjusted issue price of the Securities, such excess or discount would not be subject to the generally applicable market discount or amortizable bond premium rules described in the accompanying prospectus but rather would be subject to special rules set forth in Treasury Regulations governing contingent debt instruments. Accordingly, if you purchase your Securities in the secondary market, you should consult your tax advisor as to the possible application of such rules to you.

Alternatively, it would also be possible to treat your Security, and the Internal Revenue Service might assert that your Security should be treated as an investment unit consisting of a pre-paid forward contract with respect to the EUR/USD exchange rate (the “Forward Contract”) and a cash deposit used to secure your obligations under the forward contract (the “Cash Deposit”). If your Securities are so treated, you would be required to accrue interest income over the term that you hold your Securities even though no interest payments would be made on your Securities. Upon the sale, redemption or maturity of your Securities, you would be required to allocate the portion of the amount received for your Securities between the Forward Contract and the Cash Deposit based on the respective fair market value of each on the date of sale, redemption or maturity. You would generally recognize ordinary gain or loss to the extent the amount allocated to the Forward Contract exceeds your basis in the Forward Contract unless you properly elect to treat such gain or loss as capital gain or loss and you further comply with the verification requirements as described above. Your basis in the Forward Contract portion of the Securities would generally be equal to the amount allocated to the purchase price of the Forward Contract. Upon the sale, redemption or maturity of your Securities, you may recognize ordinary gain or loss on the portion of the Securities treated as a Cash Deposit. If you purchase your Securities in the secondary market and the portion of your purchase price that is allocated to the Cash Deposit is at a discount from, or in excess of, the adjusted issue price of the Cash Deposit, you should consult your tax advisor as to the possible application of the market discount and amortizable bond premium rules to you.

Table of Contents

Information Reporting and Backup Withholding

Please see the discussion "Tax Considerations – United States Taxation – U.S. Holders –Information Reporting and Backup Withholding" in the accompanying prospectus for a description of the applicability of the information reporting and backup withholding rules to payments made on your Securities.

SUPPLEMENTAL PLAN OF DISTRIBUTION

We intend to sell a portion of the Securities on the inception date at 100% of their stated principal amount. The remainder of the Securities will be offered and sold from time to time through Barclays Capital Inc., our affiliate, as agent. Sales of the Securities after the inception date will be made at market prices prevailing at the time of sale, at prices related to market prices or at negotiated prices. We will receive proceeds equal to 100% of the price at which the Securities are sold to the public. Barclays Capital Inc. will not receive an agent's commission in connection with sales of the Securities.

In connection with this offering, we will sell the Securities to dealers as principal, and such dealers may then resell Securities to the public at varying prices that the dealers will determine at the time of resale. In addition, such dealers may make a market in the Securities, although none of them are obligated to do so and any of them may stop doing so at any time without notice. This prospectus (including this pricing supplement and the accompanying prospectus and prospectus supplement) may be used by such dealers in connection with market-making transactions. In these transactions, dealers may resell a Security covered by this prospectus that they acquire from other holders after the original offering and sale of the Securities, or they may sell a Security covered by this prospectus in short sale transactions.

Broker-dealers and other persons are cautioned that some of their activities may result in their being deemed participants in the distribution of the Securities in a manner that would render them statutory underwriters and subject them to the prospectus delivery and liability provisions of the Securities Act. Among other activities, broker-dealers and other persons may make short sales of the Securities and may cover such short positions by borrowing Securities from us or our affiliates or by purchasing Securities from us or our affiliates subject to our obligation to repurchase such Securities at a later date. As a result of these activities, these market participants may be deemed statutory underwriters. A determination of whether a particular market participant is an underwriter must take into account all the facts and circumstances pertaining to the activities of the participant in the particular case, and the example mentioned above should not be considered a complete description of all the activities that would lead to designation as an underwriter and subject a market participant to the prospectus-delivery and liability provisions of the Securities Act. This prospectus will be deemed to cover any short sales of Securities by market participants who cover their short positions with Securities borrowed or acquired from us or our affiliates in the manner described above.

Table of Contents

Barclays Bank PLC and Barclays Capital Inc. have retained the services of Barclays Global Investors Services, their affiliate and an NASD member, to promote the Securities and provide certain services relating to the Securities. Barclays Global Investors Services may receive a portion of the investor fee. Underwriting compensation will not exceed a total of 8% of proceeds.

Table of Contents

ANNEX A

NOTICE OF REDEMPTION

To: [ipathredemptions@barclayscapital.com]

Subject: iPath Notice of Redemption, CUSIP No. 06739F184

[BODY OF EMAIL]

Name of holder: [ ]

Number of Securities to be redeemed: [ ]

Applicable Valuation Date: Thursday, [ ], 20[ ]

Contact Name: [ ]

Telephone #: [ ]

Acknowledgement: I acknowledge that the Securities specified above will not be redeemed unless all of the requirements specified in the pricing supplement relating to the Securities are satisfied.

Table of Contents

ANNEX B

CONFIRMATION OF REDEMPTION

Dated:

Barclays Bank PLC

Barclays Bank PLC, as Calculation Agent

Fax: 212-412-1232

Dear Sirs:

The undersigned holder of Barclays Bank PLC's $250,000,000 Medium-Term Notes, Series A, iPath[SM] Exchange-Traded Notes due May 14, 2037 CUSIP No. 06739F184, redeemable for a cash amount based on the EUR/USD exchange rate (the "Securities") hereby irrevocably elects to exercise, on the redemption date of _____, with respect to the number of Securities indicated below, as of the date hereof, the redemption right as described in the prospectus relating to the Securities (the "Prospectus"). Terms not defined herein have the meanings given to such terms in the Prospectus.

The undersigned certifies to you that it will (i) instruct its DTC custodian with respect to the Securities (specified below) to book a delivery vs. payment trade on the valuation date with respect to the number of Securities specified below at a price per Security equal to the applicable weekly redemption value, facing Barclays Capital DTC 5101 and (ii) cause the DTC custodian to deliver the trade as booked for settlement via DTC at or prior to 10:00 a.m., New York City time, on the redemption date.

Very truly yours,
[NAME OF HOLDER]

_____
Name:
Title:
Telephone:
Fax:
E-mail:

Number of Securities surrendered for redemption:_____

DTC # (and any relevant sub-account): _____
Contact Name:
Telephone:

(You must redeem at least 50,000 Securities at one time in order to exercise your right to redeem your Securities on any redemption date.)

Table of Contents

ANNEX C

STATEMENTS THAT ARE REQUIRED FOR A CAPITAL GAIN OR LOSS ELECTION

As described more fully in "Supplemental Tax Considerations — Supplemental U.S. Tax Considerations" of the pricing supplement (the "Pricing Supplement") for the iPath[SM] Exchange-Traded Notes due May 14, 2037, linked to the EUR/USD exchange rate (the "Securities"), you may elect to treat your gain or loss upon the sale, redemption, maturity or other disposition of the Securities as capital gain or loss. In order to make such an election, you must include the attached "Statement to be Included in Books and Records" in your books and records on the date that you first acquire your Securities, and you must verify such election by filing the attached "Statement to be Included With Federal Income Tax Return" as an attachment to your U.S. federal income tax return for each year in which you have held your Securities.

Alternatively, you may satisfy the election and verification requirements if you hold and dispose of your securities with an unrelated broker or dealer and certain other requirements, as discussed in detail on page PS-23 of the Pricing Supplement, are met.

Please consult with your own tax advisor regarding the U.S. federal, state and local tax consequences of the Securities in your particular circumstances as well as regarding the election to treat your gain or loss from the Securities as capital gain or loss.

Statement to be Included in Books and Records

I hereby elect to treat the Securities issued by Barclays Capital Inc. that I purchased on _____, 2007 as subject to the capital gain or loss election set forth in Treasury Regulations Section 1.988-3(b).

Statement to be Included with Federal Income Tax Return[1]

I elected to treat the Securities issued by Barclays Capital Inc. that I purchased on _____, 2007 (the "Issue Date") as subject to the capital gain or loss election set forth in Treasury Regulations Section 1.988-3(b) (the "Capital Election"). I made the Capital Election on the Issue Date and I have never held the Securities as part of a "straddle" transaction for tax purposes. [The Securities did not reach maturity in the past taxable year and I did not sell or exchange the Securities in such year.][2] I do not hold any other assets that are subject to the Capital Election.

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1 The language in this statement assumes that you have not held any other assets that were subject to the capital gain/loss election set forth in Treasury Regulations Section 1.988-3(b) in the relevant tax year. If you have held other assets that were subject to the election, you are required to use language that identifies and relates to those assets as well. Please consult your tax advisor as to the exact language to be used if you have held such other assets.

2 If the Securities reached maturity in such year, or if you sold or exchanged the Securities in such year, you should state the date that the Securities reached maturity or the date upon which you sold or exchanged the Securities.

Table of Contents

Filed Pursuant to Rule 424(b)(2)
Registration Number 333-126811

Prospectus Supplement to the Prospectus dated September 21, 2005

$10,000,000,000
BARCLAYS BANK PLC
MEDIUM-TERM NOTES, SERIES A

All Asset Classes and Structures Under One Roof[SM]

We will give you the specific terms of the notes we are offering in pricing supplements. In some cases, we may also set forth additional terms of the notes in product supplements. You should read this prospectus supplement, the related prospectus dated September 21, 2005, the applicable product supplement(s), if any, and the applicable pricing supplement carefully before you invest. If the terms described in the applicable product supplement are different or inconsistent with those described herein or in the prospectus, the terms described in the applicable product supplement will supersede. If the terms described in the applicable pricing supplement are different or inconsistent with those described herein, in the prospectus or in the applicable product supplement, if any, the terms described in the applicable pricing supplement will supersede. Information that we indicate will or may be provided in a pricing supplement may instead be provided in a product supplement.

Principal Protection

The applicable pricing supplement will specify whether your principal investment in the notes is fully protected, partially protected, contingently protected or not protected.

Principal Payment at Maturity

If you hold your notes to maturity, for each note you will receive a cash payment that may be more or less than the principal amount of each note based upon the value of the reference asset and as described in the applicable pricing supplement.

Interest Rates and Interest Payments

The notes may have a rate of interest based on (i) one or more reference assets, (ii) a fixed amount or rate or (iii) movements in the level, value or price or other events relating to one or more reference assets.

Reference Asset

The principal, interest or any other amounts payable on the notes may be based on one or more of the following or on movements in the level, value or price or other events relating to one or more: indices of equity securities, equity securities, indices of commodities, commodities, indices of foreign currencies, foreign currencies, indices of interest rates, interest rates, indices of consumer prices or other asset classes. In addition, the principal, interest or any other amounts payable on the notes may be based on measures, formula or instruments, including the occurrence or non-occurrence of any event or circumstance, or baskets comprised of any instruments or measures, as specified in the applicable pricing supplement. To the extent that amounts payable on the notes are based on a different reference asset, the terms of the applicable pricing supplement will describe that reference asset.

Maturity Date

The applicable pricing supplement will specify the maturity date.

Denominations

Unless otherwise specified in the applicable pricing supplement, the notes will be issued in minimum denominations of $1,000 (or the specified currency equivalent), increased in multiples of $1,000 (or the specified currency equivalent).

Redemption, Repayment, Repurchase or Exchange

Terms of specific notes may permit or require redemption for cash or one or more reference assets at our option or at your option. The notes may permit or require repayment or repurchase at our option or at your option. The notes may be optionally or mandatorily exchangeable for cash or one or more reference assets.

Ranking

The notes constitute our direct, unconditional, unsecured and unsubordinated obligations ranking *pari passu*, without any preference among themselves, with all our other outstanding unsecured and unsubordinated obligations, present and future, except those obligations as are preferred by operation of law.

Listing

Unless otherwise specified in the applicable pricing supplement, the notes will not be listed on any U.S. securities exchange or quotation system.

See " Risk Factors" beginning on page S-3 of this prospectus supplement for risks relating to an investment in the notes.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these notes or determined that this prospectus supplement is truthful or complete. Any representation to the contrary is a criminal offense.

The notes are not deposit liabilities of Barclays Bank PLC and are not insured by the U.S. Federal Deposit Insurance Corporation or any other governmental agency of the United States, the United Kingdom or any other jurisdiction.

Barclays Capital Inc. and other entities disclosed in the applicable pricing supplement may solicit offers to purchase the notes as our agent. We may also sell notes to any agent as principal for its own account at prices to be agreed upon at the time of sale. The agents may resell any notes they purchase as principal for its own account at prevailing market prices, or at other prices, as the agents determine. The applicable pricing supplement will disclose the agent's discounts and commissions, if any. **Unless we or our agent informs you otherwise in the confirmation of sale, the agents may use this prospectus supplement, the prospectus and the applicable pricing supplement in connection with offers and sales of the notes in market-making.**

Patent Pending

November 1, 2006

Table of Contents

TABLE OF CONTENTS
PROSPECTUS SUPPLEMENT

PROSPECTUS

Table of Contents

Offers and sales of the notes are subject to restrictions in certain jurisdictions. The distribution of this prospectus supplement, the prospectus and any pricing supplement and the offer or sale of the notes in certain other jurisdictions may be restricted by law. Persons who come into possession of this prospectus supplement, the prospectus and any pricing supplement or any note must inform themselves about and observe any applicable restrictions on the distribution of these materials and the offer and sale of the notes.

SUMMARY

The Barclays Bank Group

Barclays Bank PLC and its subsidiary undertakings (taken together, the "Group") is a major global financial services provider engaged in retail and commercial banking, credit cards, investment banking, wealth management and investment management services. The Group also operates in many other countries around the world. The whole of the issued ordinary share capital of Barclays Bank PLC is beneficially owned by Barclays PLC, which is the ultimate holding company of the Group and one of the largest financial services companies in the world by market capitalization.

You may contact our principal executive offices at 1 Churchill Place, London, E14 5HP, England. Our telephone number is 011-44-20-7116-1000.

In this prospectus supplement, unless the context otherwise requires, "we", "us" and "our" mean Barclays Bank PLC and references to "$" are to U.S. dollars.

Overview of Medium-Term Notes

The notes are a separate series of our debt securities. We summarize various terms that apply generally to our debt securities, including the notes, in the accompanying prospectus under the caption "Description of Debt Securities". The following description of the notes supplements that description of the debt securities. Consequently, you should read this prospectus supplement together with the accompanying prospectus and pricing supplement in order to understand the terms of the notes.

This section summarizes the material terms that will apply generally to the notes as a series. Each particular note will have financial and other terms specific to it. Some of those terms are described below under the captions "Terms of the Notes", "Interest Mechanics", "Certain Features of the Notes" and "Reference Assets". The specific terms of each note issuance will be described in a pricing supplement that will accompany this prospectus supplement and the prospectus. Those terms may vary from the terms described here. As you read this prospectus supplement, please remember that the specific terms of your note as described in your pricing supplement will supplement and, if applicable, may modify or replace the general terms described in this section and in the accompanying prospectus. Unless we say otherwise below, the terms we use in this prospectus supplement that we also use in the accompanying prospectus have the meanings we give them in the prospectus. Similarly, the terms we use in any pricing supplement that we also use in this prospectus supplement will have the meanings we give them in this prospectus supplement, unless we say otherwise in the pricing supplement.

The Notes Will Be Issued Under the Senior Debt Indenture

The notes are governed by the senior debt indenture between us and The Bank of New York, which acts as trustee. The trustee has two main roles:

- First, the trustee can enforce your rights against us if we default. There are limitations on the extent to which the trustee acts on your behalf, which we describe under "Description of Debt Securities" in the accompanying prospectus; and
- Second, the trustee performs administrative duties for us, such as sending you interest payments and notices.

We May Issue Other Series of Debt Securities

The senior debt indenture permits us to issue different series of debt securities from time to time. The medium-term notes are a single, distinct series of debt securities. We may, however, issue notes in those amounts, at those times and on those terms as we wish. The notes

Table of Contents

may differ from one another, and from debt securities of other series, in their terms. When we refer to “the notes”, “the medium-term notes” or “these notes”, we mean our Medium-Term Notes, Series A. When we refer to a “series” of debt securities, we mean a series, such as the notes, issued under the senior debt indenture. When we refer to a “class” of the medium-term notes, we mean notes of a certain offering that may be reopened or reissued as described below under “—Amounts That We May Issue” and “Terms of the Notes—Reissuances or Reopened Issues”, resulting in notes with different issue dates, but otherwise the same terms.

Amounts That We May Issue

The senior debt indenture does not limit the aggregate amount of debt securities that we may issue. Nor does it limit the number of series or the aggregate amount of any particular series that we may issue. Also, if we issue notes having the same terms in a particular offering, we may reissue or “reopen” that offering at any later time and offer additional notes having those terms. We intend to issue medium-term notes initially in an amount having the aggregate offering price specified on the cover of this prospectus supplement. However, we may issue additional medium-term notes in amounts that exceed the amount on the cover at any time, without your consent and without notifying you. Our affiliates, including Barclays Capital Inc., may use this prospectus supplement to resell notes in market-making transactions from time to time. We describe these transactions under “Plan of Distribution” below. The senior debt indenture and the notes do not limit our ability to incur other indebtedness or to issue other securities. Also, we are not subject to financial or similar restrictions by the terms of the notes or the senior debt indenture, except as described under “Description of Debt Securities” in the accompanying prospectus.

Ranking

The notes constitute our direct, unconditional, unsecured and unsubordinated obligations ranking pari passu, without any preference among themselves, with all our other outstanding unsecured and unsubordinated obligations, present and future, except those obligations as are preferred by operation of law.

The notes are not deposit liabilities of Barclays Bank PLC and are not insured by the U.S. Federal Deposit Insurance Corporation (“FDIC”) or any other governmental agency of the United States, the United Kingdom or any other jurisdiction.

This Section Is Only a Summary

The senior debt indenture and its associated documents, including your note, contain the full legal text of the matters described in this section and your pricing supplement. The senior debt indenture and the notes are governed by New York law. A copy of the senior debt indenture has been filed with the U.S. Securities and Exchange Commission (“SEC”) as part of our registration statements. See “Further Information” in the accompanying prospectus for information on how to obtain a copy. Investors should carefully read the description of the terms and provisions of our senior debt securities and the senior debt indenture under “Description of Debt Securities” in the accompanying prospectus. That section, together with this prospectus supplement and the relevant pricing supplement, summarize all the material terms of the senior debt indenture and your note. They do not, however, describe every aspect of the senior debt indenture and your note. For example, in the section entitled “Description of Medium-Term Notes” herein, the accompanying prospectus and your pricing supplement, we use terms that have been given special meaning in the senior debt indenture, but we describe the meaning of only the more important of those terms.

Types of Medium-Term Notes

The principal, interest or any other amounts payable on the notes may be based on one or more of the following or on movements in the level, value or price or other events relating to one or more: indices of equity securities, equity securities, indices of commodities, commodities, indices of foreign currencies, foreign currencies, indices of interest rates, indices of consumer prices, interest rates or other asset classes, In addition, the principal, interest or any other amounts payable on the notes may be based on measures, formula or instruments, including the occurrence or non-occurrence of any event or circumstance, or baskets comprised of any instruments or measures, as specified in the applicable pricing supplement. To the extent

Table of Contents

that amounts payable on the notes are based on a different reference asset, the terms of the applicable pricing supplement will describe that reference asset. See “Certain Features of the Notes” and “Reference Assets” in this prospectus supplement.

Form, Denomination and Legal Ownership of Notes

Unless otherwise specified in the applicable pricing supplement, your note will be issued:

- in registered form, without interest;
- in authorized denominations of $1,000 (or the specified currency equivalent) and integral multiples thereof; and
- in book-entry form, represented by a global note or a master global note.

You should read the section “Description of Debt Securities—Legal Ownership; Form of Debt Securities” in the accompanying prospectus for information about this type of arrangement and your rights under this type of arrangement.

RISK FACTORS

You should understand the risks of investing in the notes and should reach an investment decision, only after careful consideration with your advisors of the suitability of the notes in light of your particular financial circumstances, the following risk factors and the other information included or incorporated by reference in the applicable pricing supplement, this prospectus supplement and the prospectus. Please note that this Risk Factors section has various subsections addressing risk factors relating to specific types of reference assets and transaction structures. We have no control over a number of matters, including economic, financial, regulatory, geographic, judicial and political events, that are important in determining the existence, magnitude, and longevity of these risks and their influence on the value of, or the payments made on, the notes. You should not purchase the notes unless you understand and can bear these investment risks.

Risks Relating to All Notes

(1) The notes are intended to be held to maturity.

You may receive less, and possibly significantly less, than the amount you originally invested if you sell your notes prior to maturity. You should be willing to hold your notes until maturity.

(2) There may not be any secondary market for your notes.

Upon issuance, the notes will not have an established trading market. We cannot assure you that a trading market for the notes will develop or, if one develops, that it will be maintained. Although we may apply to list certain issuances of notes on a national securities exchange, we may not meet the requirements for listing and do not expect to announce, prior to the issuance of the notes, whether we will meet those requirements. Even if there is a secondary market, it may not provide liquidity. While we anticipate that our affiliate Barclays Capital Inc. may make a market for the notes, it is not required to do so. If the notes are not listed on any securities exchange and Barclays Capital Inc. were to cease acting as a market maker, it is likely that there would be no secondary market for the notes. You therefore must be willing and able to hold the notes until maturity.

(3) Price or other movements in reference assets and their components are unpredictable.

Movements in the level, value or price of the reference assets or their respective components are unpredictable and volatile, and are influenced by complex and interrelated political, economic, financial, regulatory, geographic, judicial and other factors. As a result, it is impossible to predict whether their levels, values or prices will rise or fall during the term of the notes. Changes in the levels, values or prices will determine the amount of interest, payments at maturity, or other amounts payable on your notes. Therefore these changes may result in a loss of principal or the receipt of little or no interest or other payments on your notes. As the notes are linked to reference assets that may be unpredictable and volatile, we cannot guarantee that these changes will be beneficial to you, and therefore you may receive less than the amount you initially invested in the notes, may not receive any interest on the notes or may experience other losses in connection with your investment in the notes.

Table of Contents

(4) The historical or hypothetical performance of the reference asset is not an indication of future performance.

The historical or hypothetical performance of the reference assets, which may be included in the applicable pricing supplement, should not be taken as an indication of the future performance of the reference asset. It is impossible to predict whether the level, value or price of the reference asset will fall or rise during the term of the notes. Past fluctuations and trends in the reference assets are not necessarily indicative of fluctuations or trends that may occur in the future.

(5) You must rely on your own evaluation of the merits of an investment in the notes.

In connection with your purchase of the notes, we urge you to consult your own financial, tax and legal advisors as to the risks involved in an investment in the notes and to investigate the reference asset and not rely on our views in any respect. You should make a complete investigation as to the merits of an investment in the notes.

(6) The price at which you will be able to sell your notes prior to maturity will depend on a number of factors, and may be substantially less than the amount you had originally invested.

If you wish to liquidate your investment in the notes prior to maturity, your only alternative, in the absence of any repayment at option of the holder provisions, would be to sell them. At that time, there may be an illiquid market for notes or no market at all. Even if you were able to sell your notes, there are many factors outside of our control that may affect their market value. We believe that the market value of your notes will be affected by the volatility of the reference asset, the level, value or price of the reference asset at the time of the sale, changes in interest rates, the supply and demand of the notes and a number of other factors. Some of these factors are interrelated in complex ways; as a result, the effect of any one factor may be offset or magnified by the effect of another factor. The price, if any, at which you will be able to sell your notes prior to maturity may be substantially less than the amount you originally invested depending upon, the level, value or price of the reference asset at the time of the sale. The following paragraphs describe the manner in which we expect the market value of the notes to be affected in the event of a change in a specific factor, assuming all other conditions remain constant.

- *Reference asset performance*. We expect that the market value of the notes prior to maturity will depend substantially on the current level (or in some cases, performance since the date on which the notes price) of the reference asset relative to its initial level, value or price. If you decide to sell your notes prior to maturity when the current level, price or value of the reference asset at the time of sale is favorable relative to its initial level, value or price, you may nonetheless receive substantially less than the amount that would be payable at maturity based on that level, value or price because of expectations that the level, value or price will continue to fluctuate until the final level, value or price is determined.
- *Volatility of the reference asset*. Volatility is the term used to describe the size and frequency of market fluctuations. If the volatility of the reference assets or their components increases or decreases, the market value of the notes may be adversely affected.
- *Interest rates*. We expect that the market value of the notes will be affected by changes in interest rates. Interest rates also may affect the economy and, in turn, the value of the components of the reference asset, which would affect the market value of the notes.
- *Supply and Demand for the Notes.* We expect that the market value of the notes will be affected by the supply of and demand for the notes. In general, if the supply of the notes decreases and/or the demand in the notes increases, the market value of the notes may increase. Alternatively, if the supply of the notes increases and/or the demand in the notes decreases, the market value of the notes may be adversely affected. The supply of the notes, and therefore the market value of the notes, may be affected by inventory positions held by Barclays Capital Inc., Barclays Capital PLC or any market maker.

Table of Contents

- *Redemption/call rights:* Either your right to redeem the notes or our right to call the notes may affect the market value of the notes. Generally, the grant of a redemption right to noteholders may enhance the market value of the notes while a call right by us may adversely affect the market value of the notes.
- *Our credit ratings, financial condition and results of operations*. Actual or anticipated changes in our current credit ratings, as well as our financial condition or results of operations may significantly affect the market value of the notes. However, because the return on the notes is dependent upon factors in addition to our ability to pay our obligations under the notes (such as the current level, value or price of the reference asset), an improvement in our credit ratings, financial condition or results of operations is not expected to have a positive effect on the market value of the notes. These credit ratings relate only to our creditworthiness, do not affect or enhance the performance of the notes and are not indicative of the risks associated with the notes or an investment in the reference asset. A rating is not a recommendation to buy, sell or hold notes and may be subject to suspension, change or withdrawal at any time by the assigning rating agency.
- *Time remaining to maturity*. A “time premium” results from expectations concerning the level, value or price of the reference asset during the period prior to the maturity of the notes. As the time remaining to the maturity of the notes decreases, this time premium will likely decrease, potentially adversely affecting the market value of the notes. As the time remaining to maturity decreases, the market value of the notes may be less sensitive to the volatility in the components of the reference asset.
- *Events affecting or involving the reference asset*. Economic, financial, regulatory, geographic, judicial, political and other developments that affect the level, value or price of the reference assets and their components, and real or anticipated changes in those factors, also may affect the market value of the notes. For example, for reference assets composed of equity securities, earnings results of a component of the reference asset, and real or anticipated changes in those conditions or results, may affect the market value of the notes.
- *Agent’s commission and cost of hedging*. The initial public offering price of the notes includes the agent’s commission or discount, if any, and the cost of hedging our obligations under the notes. These costs may include our or our affiliates’ expected cost of providing that hedge and the profit we expect to realize in consideration for assuming the risks inherent in providing that hedge. As a result, assuming no change in market conditions or any other relevant factors, the price, if any, in secondary market transactions will likely be lower than the original issue price, and could result in a substantial loss to you.

The effect of one of the factors specified above may offset some or all of any change in the market value of the notes attributable to another factor.

(7) The notes are not insured against loss by any third parties.

The notes will be solely our obligations, and no other entity will have any obligation, contingent or otherwise, to make any payments in respect of the notes.

(8) The notes are not insured by the FDIC.

The notes are not deposit liabilities of Barclays Bank PLC and neither the notes nor your investment in the notes are insured by the FDIC or any other governmental agency of the United States, United Kingdom or any other jurisdiction.

(9) There are no security interests in the notes or other financial instruments held by Barclays Bank PLC.

The indenture governing the notes does not contain any restrictions on our ability or the ability of any of our affiliates to sell, pledge or otherwise convey all or any portion of the securities or other instruments acquired by us or our affiliates. Neither we nor any of our affiliates will pledge or otherwise hold those securities or other instruments for the benefit of holders of the

Table of Contents

notes. Consequently, in the event of a bankruptcy, insolvency or liquidation involving us, any of those securities or instruments that we own will be subject to the claims of our creditors generally and will not be available specifically for the benefit of the holders of the notes. The principal, interest or any other amounts payable on the notes constitute our direct, unconditional, unsecured and unsubordinated obligations ranking *pari passu,* without any preference among themselves, with all our other outstanding unsecured and unsubordinated obligations, present and future, except those obligations as are preferred by operation of law.

(10) Reported levels, values and prices of reference assets and their components may be based on non-current information.

If trading is interrupted in the reference assets or any of their components, publicly available information regarding the level, value or price of the reference asset may be based on the last reported levels, values or prices. As a result, publicly available information regarding reported levels, values or prices of the reference assets or their components may at times be based on non-current information.

(11) The reference assets or their components may trade around-the-clock; however, if a secondary market develops, the notes may trade only during regular trading hours in the United States.

If the market for the reference assets or their components is a global, around-the-clock market, the hours of trading for the notes may not conform to the hours during which the reference assets or their components are traded. To the extent that U.S. markets are closed while international markets remain open, significant movements may take place in the levels, values or prices of the reference assets or their components that will not be reflected immediately in the price of the notes. There may not be any systematic reporting of last-sale or similar information for the reference assets or their components. The absence of last-sale or similar information and the limited availability of quotations would make it difficult for many investors to obtain timely, accurate data about the state of the market for the reference assets or their components.

(12) The calculation agent may postpone the determination of the amount you receive during the term of the notes or at maturity if a market disruption event occurs.

In some cases, the notes may be linked to a reference asset where a valuation date, observation date or averaging date, as applicable, (collectively referred to herein as a “valuation date”, and which is described in “Certain Features of the Notes—Valuation Dates, Observation Dates or Averaging Dates” below) may be postponed if the calculation agent determines that a market disruption event (described in “Reference Assets” below) has occurred or is continuing on that valuation date. If that type of postponement occurs, the calculation agent will determine the closing level, value, price or other amount with respect to that valuation date on the first succeeding business day on which no market disruption event occurs or is continuing, provided that the valuation date will not be postponed by more than five business days. You will not be entitled to compensation from us or the calculation agent for any loss suffered as a result of the occurrence of a market disruption event, any resulting delay in payment or any change in the level, value or price of the reference asset after the originally scheduled valuation date.

(13) The material U.S. federal income tax consequences of an investment in some types of notes are uncertain.

There is no direct legal authority as to the proper tax treatment of some types of notes, and therefore significant aspects of the tax treatment of some types of notes are uncertain, as to both the timing and character of any inclusion in income in respect of your note. The applicable pricing supplement will provide further detailed information as to the tax treatment of your notes. We urge you to consult your tax advisor as to the tax consequences of your investment in a note. For a more complete discussion of the U.S. federal income tax consequences of your investment in a note, please see the discussion under “Certain U.S. Federal Income Tax Considerations”.

Table of Contents

(14) The calculation agent could be one of our affiliates, which could result in a conflict of interest.

The calculation agent will make determinations and judgments in connection with valuing the reference asset and calculating adjustments to the reference asset, dates, prices, or any other affected variable when the reference asset is changed or modified as well as determining whether a market disruption event has occurred. You should refer to "Description of Medium—Term Notes—Calculations and Calculation Agent". Because the calculation agent could be our affiliate, conflicts of interest may arise in connection with the calculation agent performing its role as calculation agent.

(15) Trading and other transactions by us or our affiliates could affect the level, value or price of reference assets and their components, the market value of the notes or the amount of interest, principal or other amounts payable on your notes.

In connection with our normal business practices or in connection with hedging our obligations under the notes, we and our affiliates may from time to time buy or sell the reference assets and their components, or similar instruments, or derivative instruments relating to the reference assets or their components. These trading activities may present a conflict of interest between your interest in the notes and the interests we and our affiliates may have in our proprietary accounts, in facilitating transactions, including block trades, for our other customers and in accounts under our management. These trading activities also could affect the level, value or price of the reference assets in a manner that would decrease the market value of the notes prior to maturity or the amount you would receive at maturity. To the extent that we or any of our affiliates have a hedge position in the reference assets or their components, or in a derivative or synthetic instrument related to the reference assets or their components, we or any of our affiliates may increase or liquidate a portion of those holdings at any time before, during or after the term of the notes. This activity may affect the amount payable at maturity or any calculation of the market value of the notes in a manner that would be adverse to your investment in the notes. Depending on, among other things, future market conditions, the aggregate amount and the composition of those hedge positions are likely to vary over time. In addition, we or any of our affiliates may purchase or otherwise acquire a long or short position in the notes. We or any of our affiliates may hold or resell any such position in the notes.

(16) Research reports and other transactions may create conflicts of interest between you and us.

We or one or more of our affiliates have published, and may in the future publish, research reports relating to the reference assets or any of their components. The views expressed in this research may be modified from time to time without notice and may express opinions or provide recommendations that are inconsistent with purchasing or holding the notes. Any of these activities may affect the level, value or price of the reference assets or their components and, therefore, the market value of the notes. Moreover, other professionals who deal in these markets may at any time have views that differ significantly from ours. In connection with your purchase of the notes, you should investigate the reference asset and not rely on our views with respect to future movements in the reference assets and their components.

We or any of our affiliates also may issue, underwrite or assist unaffiliated entities in the issuance or underwriting of other securities or financial instruments with returns indexed to the reference asset. By introducing competing products into the marketplace in this manner, we or our affiliates could adversely affect the market value of the notes.

We and our affiliates, at present or in the future, may engage in business relating to the person or organization responsible for calculating, publishing or maintaining the reference assets, which we refer to as the "sponsor" of the reference asset. In addition, we or our affiliates may engage in business relating to any components of the reference assets, including making loans to, equity investments in, or providing investment banking, asset management or other advisory services to the respective sponsor or issuer. In connection with these activities, we may receive information pertinent to the reference assets or their components that we will not divulge to you.

Table of Contents

(17) We cannot control actions by the sponsors or issuers of the reference asset.

Actions by any sponsor or issuer of the reference asset may have an adverse effect on the price of the reference asset and therefore on the market value of the notes. No sponsor or issuer will be involved with the administration, marketing or trading of the notes and no sponsor will have any obligations with respect to the amounts to be paid to you on any interest payment date or on the maturity date, or to consider your interests as an owner of notes when it takes any actions that might affect the market value of the notes. No sponsor will receive any of the proceeds of any note offering and no sponsor or issuer will be responsible for, or have participated in, the determination of the timing of, prices for, or quantities of, the notes to be issued.

Unless otherwise specified in the applicable pricing supplement, we will not be affiliated with any sponsor or issuer of the reference assets (except for the licensing arrangements, if any, discussed in this prospectus supplement or the applicable pricing supplement), and we have no ability to control or predict their actions. These actions could include mergers or tender offers in the case of reference assets consisting of securities or errors in information disclosed by a sponsor of an index or an issuer of an equity security or any discontinuance by them of that disclosure. However, we may currently, or in the future, engage in business with the sponsors or issuers. Neither we, nor any of our affiliates, including the agent, assumes any responsibility for the adequacy or accuracy of any publicly available information about the sponsor or issuer of the reference assets, whether the information is contained in the pricing supplement or otherwise. You should make your own investigation into the reference assets and their sponsors or issuers.

(18) No research recommendation on your notes.

Although Barclays Bank PLC or one or more of our affiliates may publish research on, or assign a research recommendation to, other financial products linked to the performance of any of the reference assets, neither Barclays Bank PLC nor any of its subsidiaries or affiliates publishes research on, or assigns a research recommendation to, your notes.

(19) You have no recourse to the sponsor or issuer of the reference asset or any components of the reference asset.

Your investment in the notes will not give you any rights against any sponsor or any issuer of the reference assets or any components of the reference assets, including any sponsor that may determine or publish the level, value or price of the reference assets and any issuer that may otherwise affect the level, value or price of the reference assets.

(20) Changes in methodology of the sponsor of certain reference assets or changes in laws or regulations, may affect the value of and payment of principal, interest or other amounts payable on your notes.

The sponsors of reference assets may have the ability from time to time to change any rule or bylaw or take emergency action under its rules, any of which could affect the level, value or price of the reference asset or a component of the reference asset. Any change of that kind which causes a change in the level, value or price could adversely affect the market value of the notes.

In addition, levels, values or prices of the reference asset could be adversely affected by the promulgation of new laws or regulations or by the reinterpretation of existing laws or regulations (including, without limitation, those relating to taxes and duties on any reference asset) by one or more governments, governmental agencies or instrumentalities, courts or other official bodies. Any of these events could adversely affect the level, value or price of the reference asset and, correspondingly, could adversely affect the market value of the notes.

(21) Any of the indices comprising the reference assets may be discontinued; the manner in which the reference assets are calculated may change in the future and the instruments comprising the components of the indices, or their respective weights, may change.

There can be no assurances that the reference assets will continue or the method by which the

Table of Contents

reference assets are calculated will remain unchanged. Changes in the method in which the reference assets are calculated could reduce the level of the reference asset and, as a consequence, adversely affect the amount of principal, interest, or any other amounts payable on your notes or the market value of your notes. In addition, if the reference asset is discontinued or altered, a substitute index may be employed to calculate the amount of principal, interest or any other amounts payable on your notes. This substitution may adversely affect the market value of the notes.

Further, the sponsor of reference assets that are indices can add, delete or substitute the instruments comprising the components of the reference asset or make other methodological changes that could adversely change the level of the reference asset and, therefore, the market value of the notes. You should realize that changes in the components of the reference asset may affect the reference asset, as a newly added instrument or instruments may perform significantly better or worse than the instrument or instruments it replaces. We have no control over the way the reference assets are calculated by the sponsor.

(22) Any discontinuance or suspension of calculation or publication of the closing levels or prices of the reference asset may adversely affect the market value of the notes and the amount you will receive at maturity.

If the calculation or publication of the closing levels or prices of the reference asset is discontinued or suspended, it may become difficult to determine the market value of the notes or, if the discontinuance or suspension is continuing on a valuation date, the level or price for that respective date and the amount of interest or other payment amounts determined on such date. If the discontinuance or suspension is continuing on the final valuation date, final observation date or final averaging date (collectively referred to herein as the "final valuation date" and described under "Certain Features of the Notes—Final Valuation Date, Final Observation Date or Final Averaging Date" below), it may become difficult to determine the amount of interest, payments at maturity or other amounts payable at maturity.

Additional Risks Relating to Notes with Reference Assets That Are Equity Securities, That Contain Equity Securities or That Are Based in Part on Equity Securities

(23) Equity market risks may affect the market value of the notes and the amount you will receive at maturity.

If the reference asset is an index that includes one or more equity securities, we expect that the reference asset will fluctuate in accordance with changes in the financial condition of the relevant issuer(s) of its component stocks, the value of common stocks generally and other factors. The financial condition of the issuer(s) of the components of the reference asset may become impaired or the general condition of the equity market may deteriorate, either of which may cause a decrease in the level of the reference asset and thus in the market value of the notes. Common stocks are susceptible to general equity market fluctuations and to volatile increases and decreases in value, as market confidence in and perceptions regarding the security or securities comprising a reference asset change. Investor perceptions regarding the issuer of a security comprising a reference asset are based on various and unpredictable factors, including expectations regarding government, economic, monetary and fiscal policies, inflation and interest rates, economic expansion or contraction, and global or regional political, economic, and banking crises.

(24) You have no rights in the property, nor shareholder rights in any securities of any issuer, of the security or securities comprising the reference asset.

Investing in the notes will not make you a holder of the security or securities comprising the reference asset. Neither you nor any other holder or owner of the notes will have any voting rights, any right to receive dividends or other distributions or any other rights with respect to any property or securities of any issuer or issuers of the security or securities comprising the reference asset.

(25) Payments on the notes will not reflect dividends on any of the securities underlying the reference asset.

Payments at maturity do not reflect the payment of dividends on any of the common stocks underlying the reference asset. Therefore, the yield derived from an investment in the notes will not be the same as if you had purchased the common stocks underlying the reference asset and held them for a similar period.

Table of Contents

(26) We obtained the information about the sponsor or issuer of the reference asset from public filings.

We have derived all information in this prospectus supplement or the applicable pricing supplement about the sponsor or issuer of the reference asset from publicly available documents. We have not participated and will not participate in the preparation of any of those documents. Nor have we made or will we make any "due diligence" investigation or any inquiry with respect to the sponsor or issuer of the reference asset in connection with the offering of the notes. We do not make any representation that any publicly available document or any other publicly available information about the sponsor or issuer of the reference asset is accurate or complete. Furthermore, we do not know whether all events occurring before the date of this prospectus supplement or the applicable pricing supplement including events that would affect the accuracy or completeness of the publicly available documents referred to above or the level, value or price of the reference asset, have been publicly disclosed. Subsequent disclosure of any events of this kind or the disclosure of or failure to disclose material future events concerning the sponsor or issuer of reference asset could affect the value you will receive during the term of the notes or at maturity and, therefore, the market value of the notes.

(27) Any of the issuers of the securities comprising the reference assets may perform an action that could adversely affect the market value of the notes.

The calculation agent may adjust any date, price (including but not limited to the initial price, final price, barrier price and strike price), barrier percentage, physical delivery amount, any combination thereof or any other variable for stock splits, mergers, tender offers, reverse stock splits, stock dividends, extraordinary dividends and other corporate events that affect capital structure of the issuer of the equity security comprising the reference asset, as well as for certain actions taken by any depositary for the reference asset (*e.g.,* American depositary shares) that affect the reference asset in the situations and in the manner described in "Reference Assets—Securities or 'Linked Shares'—Share Adjustments Relating to Notes with an Equity Security as the Reference Asset" and in the applicable pricing supplement. However, the calculation agent is not required to make an adjustment for every corporate event that may affect the reference asset or any component of the reference asset. Any of the above events or other actions by the issuer of the reference asset or a third party may adversely affect the market value of the reference asset and, therefore, adversely affect the market value of the notes.

(28) Reference assets or their components traded in an international market may be subject to additional risk.

The levels, values, prices and performance of reference assets and their components traded in international markets may be affected by political, economic, financial and social factors in the relevant international market. In addition, recent or future changes in that country's government, economic and fiscal policies, the possible imposition of, or changes in, currency exchange laws or other laws or restrictions, and possible fluctuations in the rate of exchange between currencies, are factors that could adversely affect the international securities markets. Moreover, the relevant international economy may differ favorably or unfavorably from that of the United States.

(29) Time differences between the domestic and international markets and New York City may create discrepancies in the market value of the notes if the reference assets or their components primarily trade on international markets.

In the event that the reference assets or their components trade primarily on an international market, time differences between the domestic and international markets (e.g., New York City is currently five and 13 hours behind London and Tokyo, respectively) may result in discrepancies between the level of the reference assets (or the price of their components) and the market value of the notes. To the extent that U.S. markets are closed while markets for the reference assets or their components remain open, significant price or rate movements may take place in the reference assets or their

Table of Contents

components that will not be reflected immediately in the market value of the notes. In addition, there may be periods when the relevant international markets are closed for trading (e.g., during holidays in an international country), causing the level of the reference assets (or the price of their components) to remain unchanged for multiple trading days in New York City.

(30) Your return may be affected by factors affecting international securities markets.

The reference asset may include, as a component, securities issued by international companies and may be denominated in a foreign currency. Investors should be aware that investments in reference assets linked to the value of international securities (or indices relating to those securities) might involve particular risks. The international securities comprising or relating to a reference asset may have less liquidity and could be more volatile than many of the securities traded in U.S. or other longer-established securities markets. Direct or indirect government intervention to stabilize the relevant international securities markets, as well as cross shareholdings in international companies, may affect trading prices and volumes in those markets. Also, there is generally less publicly available information about international companies than about those U.S. companies that are subject to the reporting requirements of the SEC; and international companies often are subject to accounting, auditing and financial reporting standards and requirements that differ from those applicable to U.S. reporting companies. The other special risks associated with international securities may include, but are not necessarily limited to: less liquidity and smaller market capitalizations; less rigorous regulation of securities markets; different accounting and disclosure standards; governmental interference; higher inflation; and social, economic and political uncertainties.

These factors may adversely affect the performance of the reference assets or their components and, as a result, the market value of the notes and the amount you will receive at maturity.

(31) The issuer of a security that serves as a reference asset could take actions that may adversely affect a note.

The issuer of a security that serves as the reference asset or a component of an index which is the reference asset for a note will have no involvement in the offer and sale of the note and no obligation to you. The issuer may take action, such as a merger or sale of assets, without regard to the interests of the holder. Any of these actions could adversely affect the value of that security, the reference asset or a component of the reference asset and, correspondingly, could adversely affect the market value of the note.

Additional Risks Relating to Notes with Reference Assets That Are Commodities, an Index Containing Commodities or Based in Part on Commodities

(32) Prices of commodities are highly volatile.

Commodities prices are highly volatile and are affected by numerous factors in addition to economic activity. These include political events, weather, labor activity, direct government intervention, such as embargos, and supply disruptions in major producing or consuming regions. Those events tend to affect prices worldwide, regardless of the location of the event. Market expectations about these events and speculative activity also cause prices to fluctuate. These factors may adversely affect the performance of the reference assets or their components and, as a result, the market value of the notes and the amount you will receive at maturity.

(33) The prices of certain commodities may be subject to price ceilings.

Certain exchanges have regulations that limit the amount of fluctuation in futures contract prices which may occur during a single business day. These limits are generally referred to as “daily price fluctuation limits”, and the maximum or minimum price of a futures contract on any given day as a result of these limits is referred to as a “limit price.” Once the limit price has been reached in a particular futures contract, no trades may be made at a different price. Limit prices may have the effect of precluding trading in a particular contract or forcing the liquidation

Table of Contents

of futures contracts at disadvantageous times or prices. These circumstances could adversely affect the prices of the commodities comprising the reference asset and, therefore, could adversely affect the value of the notes.

(34) Suspensions or disruptions of market trading in the commodity markets and related futures markets may adversely affect the amount of principal, interest or any other amounts payable on your notes and/or the market value of the notes.

The commodity markets are subject to temporary distortions or other disruptions due to various factors, including a lack of liquidity in the markets, the participation of speculators and potential government regulation and intervention. In addition, some futures exchanges have regulations that limit the amount of fluctuation in futures contract prices that may occur during a single business day. These limits are generally referred to as "daily price fluctuation limits" and the maximum or minimum price of a contract on any given day as a result of these limits is referred to as a "limit price". Once the limit price has been reached in a particular contract, no trades may be made at a different price. Limit prices may have the effect of precluding trading in a particular contract or forcing the liquidation of contracts at disadvantageous times or prices which could have an adverse effect on the market value of the notes. These factors may adversely affect the performance of the reference assets or their components and, as a result, the market value of the notes and the principal, interest and other amounts payable on the notes.

(35) Risks relating to trading of the reference assets and their components on international futures exchanges.

Certain international futures exchanges operate in a manner more closely analogous to the over-the-counter physical commodity markets than to the regulated futures markets, and certain features of U.S. futures markets are not present. For example, there may not be any daily price limits which would otherwise restrict the extent of daily fluctuations in the prices of the respective contracts. In a declining market, therefore, it is possible that prices would continue to decline without limitation within a trading day or over a period of trading days. This may adversely affect the performance of the reference assets or their components and, as a result, the market value of the notes and the principal, interest or any other amounts payable on your notes.

(36) You may not have any rights to receive the reference assets or their components.

Investing in the notes will not make you a holder of any commodity or futures contract relating to the reference assets or their components. The notes will be paid in U.S. dollars or the specified currency stated in the applicable pricing supplement, and you will have no right to receive delivery of any commodity or futures contract relating to the reference assets or their components.

(37) Lack of regulation of the notes linked to commodities, basket of commodities or index of commodities.

The net proceeds to be received by us from the sale of notes relating to one or more commodities or basket (or an index thereon) will not be used to purchase or sell any commodity futures contracts or options on futures contracts for your benefit. An investment in the notes thus does not constitute either an investment in futures contracts, options on futures contracts or in a collective investment vehicle that trades in these futures contracts (i.e., the notes will not constitute a direct or indirect investment by you in the futures contracts), and you will not benefit from the regulatory protections of the Commodity Futures Trading Commission, commonly referred to as the "CTFC". We are not registered with the CFTC as a futures commission merchant and you will not benefit from the CFTC's or any other non-U.S. regulatory authority's regulatory protections afforded to persons who trade in futures contracts on a regulated futures exchange through a registered futures commission merchant. Unlike an investment in the notes, an investment in a collective investment vehicle that invests in futures contracts on behalf of its participants may be subject to regulation as a commodity pool and its operator may be required to be registered with and regulated by the CFTC as a commodity pool operator, or qualify for an exemption from the registration requirement. Because the notes will not be interests in a commodity pool, the notes will not

Table of Contents

be regulated by the CFTC as a commodity pool, we will not be registered with the CFTC as a commodity pool operator, and you will not benefit from the CFTC's or any non-U.S. regulatory authority's regulatory protections afforded to persons who invest in regulated commodity pools.

(38) The level of reference assets or the levels, values or prices of their components can fluctuate widely due to supply and demand disruptions in major producing or consuming regions.

The level of reference assets or the prices of their components can fluctuate widely due to supply and demand disruptions in major producing or consuming regions. In particular, recent growth in industrial production and gross domestic product has made many developing countries, particularly China, disproportionately large users of commodities and has increased the extent to which the reference assets rely on the markets of these developing countries. Political, economic and other developments that affect these developing countries may affect the level of the reference assets or the price of their components and, thus, the market value of the notes. Because the reference assets may be produced in a limited number of countries and may be controlled by a small number of producers, political-, economic- and supply-related events in those countries could have a disproportionate impact on the level of those reference assets or the price of their components.

Additional Risks Relating to Notes with Reference Assets that are Currencies, an Index Containing Currencies or Based in Part on Currencies

(39) Notes relating to currencies may be subject to foreign exchange risk.

The price relationship between two different currencies (e.g., the U.S. dollar and the Indian rupee) may be highly volatile and varies based on a number of interrelated factors, including the supply and demand for each currency, political, economic, legal, financial, accounting and tax matters and other actions that we cannot control. Relevant factors include, among other things, the possibility that exchange controls could be imposed or modified, the possible imposition of other regulatory controls or taxes, the overall growth and performance of the local economies, the trade and current account balance between the relevant countries, market interventions by the central banks, inflation, interest rate levels, the performance of the global stock markets, the stability of the relevant governments and banking systems, wars, major natural disasters and other foreseeable and unforeseeable events. In addition, the value of a currency may be affected by the operation of, and the identity of persons and entities trading on, interbank and interdealer foreign exchange markets. These factors may adversely affect the performance of the reference assets or their components and, as a result, the market value of the notes and the amount you will receive at maturity.

(40) You may not have any rights to receive the reference assets or their components.

Investing in the notes will not make you a holder of any currency or futures contract relating to the reference assets or their components. The notes will be paid in U.S. dollars or the specified currency stated in the applicable pricing supplement, and you will have no right to receive delivery of any currency or futures contract relating to the reference assets or their components.

(41) The liquidity, market value, the amount of principal, interest or any other amounts payable on your notes could be affected by the actions of the relevant sovereign governments.

Currency exchange rates of most economically developed nations are "floating", meaning the rate is permitted to fluctuate in value. However, governments, from time to time, may not allow their currencies to float freely in response to economic forces. Moreover, governments, including those of the United States, use a variety of techniques, such as intervention by their central bank or imposition of regulatory controls or taxes, to affect the currency exchange rates of their respective currencies. Governments also may issue a new currency to replace an existing currency or alter the currency exchange rate or relative exchange characteristics by devaluation or revaluation of a currency. Thus, a special risk in purchasing notes relating to one or more foreign currencies is that their liquidity, their value and the amount

Table of Contents

of principal, interest or other amounts payable on your notes could be affected by the actions of sovereign governments which could change or interfere with currency valuation and the movement of currencies across borders. There will be no adjustment or change in the terms of those notes in the event that currency exchange rates should become fixed, or in the event of any devaluation or revaluation or imposition of exchange or other regulatory controls or taxes, or in the event of the issuance of a replacement currency or in the event of any other development affecting the relevant currencies.

However, the government that issues that currency will also have no involvement in the offer and sale of the note and no obligations to you.

Additional Risks Relating to Notes Which Are Not Fully Principal Protected or Are Contingently Protected

(42) The notes are not fully principal protected and you may lose some or all of your principal.

The full principal amount of your investment is not protected, or is only contingently protected, and you may receive less, and possibly significantly less, than the amount you invested. Changes in the final level, value or price (terms described in "Terms of the Notes" below) of the reference asset could adversely affect the amount of principal, interest or any other amounts payable on your notes. Therefore, these changes may result in a loss of principal or the receipt of little or no interest or other payments on your notes. This will be true even if the level, value or price of the reference asset as of some date or dates prior to the final valuation date may have been above the initial level, value or price, because the principal, interest and any other amounts payable on your notes will be calculated only on the basis of the levels, values or prices of the reference asset on the valuation dates subsequent to the initial valuation date. You should therefore be prepared to realize no return on your notes during their term or even a loss of all of your principal investment.

Additional Risks Relating to Notes with a Maximum Return, Maximum Rate, Ceiling or Cap

(43) Your gain on the notes at maturity will be limited to the maximum return, maximum rate, ceiling or cap.

Your payment at maturity is based on the return of the reference asset, which if positive, may be subject to the maximum return, maximum rate, ceiling or cap (collectively referred to herein as a "maximum return" and are described under "Certain Features of the Notes—Maximum Return, Maximum Rate, Ceiling or Cap" below). In the event that the maximum return is applicable, the maximum payment at maturity for each note will be the sum of (i) the principal amount of the note and (ii) the product of the principal amount of the note and the maximum return, regardless of the positive percentage increase of the reference asset or any of its components.

Additional Risks Relating to Notes with a Barrier Percentage or a Barrier Level

(44) The price at which you will be able to sell your notes prior to or at the maturity date will depend on whether the closing level, value or price of the reference asset ever fell below the barrier level or percentage.

The market value of the notes will be affected if the closing level, value or price of the reference asset declines and if it ever approaches or falls below the barrier level, barrier percentage or protection price (terms are described in "Terms of the Notes" below). This type of occurrence will mean that the principal amount of your notes is not protected and you may receive less, and possibly significantly less, than the amount you invested.

Additional Risks Relating to Notes Which Pay No Interest

(45) Your yield may be lower than the yield on a standard debt security of comparable maturity.

You will not generally receive periodic payments of interest on the notes as there would be on a conventional fixed-rate or floating-rate debt security having the same maturity date and issuance date as the notes. The effective yield

Table of Contents

to maturity of the notes may therefore be less than that which would be payable on that type of conventional debt security. Therefore, the return of each note at maturity may not compensate you for any opportunity cost implied by inflation and other factors relating to the time value of money.

Additional Risks Relating to Notes with a Reference Asset That Are a Floating Interest Rate, an Index Containing Floating Interest Rates or Based in Part on a Floating Interest Rate

(46) You may receive a lesser amount of interest in the future.

Because the reference asset will be comprised of or based in part on a floating interest rate, there will be significant risks not associated with a conventional fixed-rate debt security. These risks include fluctuation of the applicable interest rate and the possibility that, in the future, you will receive a lesser amount of interest or no interest at all. We have no control over a number of matters that may affect interest rates, including economic, financial and political events that are important in determining the existence, magnitude and longevity of these risks and their results. In recent years, interest rates have been volatile, and volatility also could be characteristic of the future.

(47) The interest rate may be below the rate otherwise payable on similar notes with a floating interest rate issued by us or another issuer with the same credit rating.

Because the reference asset will be comprised of or based in part on a floating interest rate, you may receive a rate of interest that is less than the rate of interest on debt securities with the same maturity issued by us or an issuer with the same credit rating.

(48) The notes may be subject to a maximum interest rate, which will limit your return.

If the reference asset is comprised of or based in part on a floating interest rate, the notes may be subject to a maximum interest rate. The rate of interest that will accrue will never exceed the maximum rate permitted by New York law, as modified by federal law.

(49) If the notes contain a coupon conversion right, our exercise of that right will depend on market interest rates.

Whether or not we exercise a coupon conversion right (described in “Terms of the Notes” below) will depend on movements in market interest rates compared to the applicable reference asset. We will exercise the coupon conversion right and elect to cease accreting and compounding interest in favor of paying interest to you on a period basis without compounding, at our sole discretion. If we exercise our coupon conversion right, you may not be able to reinvest any interest we pay you at a rate equal to the applicable reference asset.

(50) The interest rate on the notes could be zero.

We have no control over the fluctuations in the levels of the reference assets. If the interest payments depend on a formula that uses the reference asset as a variable, certain values of the reference asset may result in a calculation that equals zero. In that case, no interest may accrue for the related interest payment period.

Additional Risks Relating to Notes Which Contain a Multiplier

(51) Changes in the levels, values and prices of the reference assets will intensify any changes to the reference asset.

If the principal, interest or any other amounts payable on the notes is dependent on a multiplier, movements in the levels, values and prices of reference assets during each interest payment period will be intensified. As a result, small changes in any of the reference assets are expected to have a greater effect than notes without a multiplier.

Additional Risks Relating to Notes Which We May Call or Redeem (Automatically or Otherwise)

(52) Market factors may influence whether we exercise our right to call or redeem the notes prior to their scheduled maturity.

It is possible that we will call or redeem the notes prior to the maturity date. If the notes are redeemed prior to their maturity date, you may

Table of Contents

be subject to reinvestment rate risk whereby it is likely that you will be unable to invest in securities with similar risk and yield as the notes. Your ability to realize market value appreciation is limited by our right to call the notes prior to the maturity date.

(53) If subject to an automatic call, the appreciation potential of the notes is limited.

Any gain on the notes will be limited to the call premium, if any, applicable to the review date on which the notes are called, regardless of the appreciation of the reference asset, which may be greater than the applicable call premium. In addition, the automatic call feature of the notes may shorten the term of your investment.

(54) The amount we will pay you to call your notes because we are required to pay additional amounts in respect of tax withholding is uncertain.

If we redeem your notes because we are required to pay additional amounts in respect of withholding, or deduction of taxes from any payment on the notes, we will pay you a redemption price for your notes that will be determined by the calculation agent in a manner reasonably calculated to preserve your and our relative economic positions. This redemption price would take into consideration the net present value of expected future payments of the principal and interest on the notes. If there are little or no expected future interest payments on the notes, the net present value would primarily depend on the present value of the repayment of the principal amount at maturity, which could result in a net present market value of the notes below par.

Additional Risks Relating to Notes with More Than One Reference Asset (a "Basket")

(55) The basket may not be a recognized market index and may not accurately reflect global market performance.

The basket may not be a recognized market index and may be created solely for purposes of the offering of the notes and calculated solely during the term of the notes. In that instance, the level of the basket and, therefore, its performance will not be published as a separate index during the term of the notes.

(56) Risks associated with the basket may adversely affect the market price of the notes.

Because the notes may be linked to changes in the values of a limited number of reference assets, the basket may be less diversified than funds or portfolios investing in broader markets and, therefore, could experience greater volatility. An investment in those notes may carry risks similar to a concentrated investment in a limited number of industries or sectors.

(57) The components of the reference assets and the reference assets comprising the basket may not move in tandem; and gains in one such instrument may be offset by declines in another such instrument.

Price movements in the components of the reference assets and the reference assets comprising the basket may not move in tandem with each other. At a time when the level, value or price of one or more of those instruments increases, the level, value or price of one or more of the other of those instruments may decline. Therefore, increases in the level, value or price of one or more of the components of the reference asset and the reference assets comprising the basket may be moderated, or wholly offset, by lesser increases or declines in the level, value or price of one or more of the other components of the reference asset and the reference assets comprising the basket.

(58) The basket may be highly concentrated in one or more geographic regions, industries or economic sectors.

The notes are subject to the downside risk of an investment in the basket, which may be highly concentrated in securities or other instruments representing a particular geographic region, industry or economic sector. These include the risks that the price, value or level of other assets in these geographic regions, industries or economic sectors or the prices of securities or other components of the reference asset and the reference assets comprising the basket may decline, thereby adversely affecting the market value of the notes. If the basket is concentrated in a geographic region, an industry or group of industries or a particular economic sector, the notes also will be concentrated in that industry or group of industries or economic sector.

Table of Contents

For example, a financial crisis could erupt in a particular geographic region, industry or economic sector and lead to sharp declines in the currencies, stock markets and other asset prices in that geographic region, industry or economic sector, threatening the particular financial systems, disrupting economies and causing political upheaval. A financial crisis or other event in any geographic region, industry or economic sector could have a negative impact on some or all of the reference assets and the basket and, consequently, the market value of the notes may be adversely affected.

(59) The correlation among the components comprising the basket may change.

Correlation is the term used to describe the relationship between the percentage change among the components. Changes in the correlation may adversely affect the market value of the notes.

Additional Risks Relating to Notes with More Than One Reference Asset, Where the Performance of the Note Is Linked to the Performance of Only One Reference Asset.

(60) Although the notes may initially be linked to more than one reference asset, losses may be linked to the performance of only one reference asset.

While the note may initially be linked to more than one reference asset, losses may be linked to the performance of only one reference asset. The note may be linked to the reference asset that has exhibited the greatest percentage price decline or the lowest percentage price increase (if the final price of each reference asset is greater than its respective initial price). In either case, gains in any of the other reference assets will be irrelevant. Further, if the notes are linked to the worst performing reference asset among multiple reference assets, there may be a greater risk of your notes being linked to a poor performing reference asset, and therefore a greater risk of you receiving no return in excess of your initial investment if your notes are principal protected and a greater risk of loss if your notes are not principal protected.

Additional Risks Relating to Digital Notes

(61) You will not participate in any appreciation in the value of the reference asset.

Some notes, which are sometimes referred to as “digital notes”, are notes that pay interest, if any, at maturity and that do not reflect the extent to which a reference asset appreciates. For example, if the final price of the reference asset is greater than the initial price of the reference asset, the interest payment you receive with respect to the notes and the principal payment you receive at maturity will be a fixed amount and not reflect the performance of the reference asset. Under no circumstances, regardless of the extent to which the value of the reference asset appreciates, will your return exceed the applicable interest rate. For example, if the reference asset has appreciated by 50% as of the final valuation date, you will receive only your principal amount plus the applicable interest payments made at maturity of the notes. In this case, you may earn significantly less by investing in the notes than you would have earned by investing directly in the reference asset.

Additional Risks Relating to Notes Payable in a Currency other than U.S. Dollars.

(62) The unavailability of foreign currencies could result in a substantial loss to you.

Banks may not offer non-U.S. dollar denominated checking or savings account facilities in the United States. Accordingly, payments on non-U.S. dollar denominated notes will be made from an account with a bank located in the country issuing the specified currency. As a result, you may have difficulty converting or be unable to convert those specified currencies into U.S. dollars on a timely basis or at all.

(63) Changes in foreign currency exchange rates and foreign exchange controls could result in a substantial loss to you.

An investment in the notes that is denominated in a specified currency other than U.S. dollars, entails significant risks that are not associated with a similar investment in a security denominated in U.S. dollars. Risks include, without limitation, the possibility of significant changes in rates of exchange between the U.S.

Table of Contents

dollar and the relevant foreign currencies or composite currencies and the possibility of the imposition or modification of foreign exchange controls by either the United States or international governments. These risks generally depend on factors over which we have no control, such as economic and political events or the supply of and demand for the relevant currencies. In recent years, rates of exchange between the U.S. dollar and certain foreign currencies have been highly volatile and that volatility also could occur in the future. If a note is non-U.S. dollar denominated, changes in rates of exchange between the U.S. dollar and the relevant foreign currency could adversely affect the effective yield of the note below its interest rate, and in some circumstances could result in a loss to the investor on a U.S. dollar basis.

Governments have imposed, and may in the future impose, exchange controls that could affect currency exchange rates, as well as the availability of a specified foreign currency for making payments with respect to a non-U.S. dollar denominated note. There can be no assurance that exchange controls will not restrict or prohibit payments in any of those currencies or currency units. Even if there are no actual exchange controls, it is possible that the specified currency for any particular note would not be available to make payments when due. In that event, we will repay that note in U.S. dollars on the basis of the most recently available currency exchange rate.

(64) Non-U.S. dollar notes may permit us to make payments in U.S. dollars or delay payment if we are unable to obtain the specified currency.

Notes payable in a currency other than U.S. dollars may provide that, if the other currency is subject to convertibility, transferability, market disruption or other conditions affecting its availability at or about the time when a payment on the notes comes due because of circumstances beyond our control, we will be entitled to make the payment in U.S. dollars or delay making the payment. We will describe these provisions in the pricing supplement relating to your notes. These circumstances could include the imposition of exchange controls or our inability to obtain the other currency because of a disruption in the currency markets. If we made payment in U.S. dollars, the currency exchange rate we would use would be determined in the manner described in the accompanying prospectus under “Description of Debt Securities—Legal Ownership; Form of Debt Securities—Payment and Paying Agents” and under “Description of the Medium-Term Notes —Payment and Paying Agents”. A determination of this kind may be based on limited information and would involve significant discretion on the part of the exchange rate agent appointed by us. As a result, the value of the payment in U.S. dollars an investor would receive on the payment date may be less than the value of the payment the investor would have received in the other currency if it had been available, or may be zero. In addition, a government may impose extraordinary taxes on transfers of a currency. If that happens, we will be entitled to deduct these taxes from any payment on notes payable in that currency.

(65) We will not adjust non-U.S. dollar notes to compensate for changes in currency exchange rates.

Except as described in the applicable pricing supplement, we will not make any adjustment or change in the terms of a non-U.S. dollar note in the event of any change in currency exchange rates for the relevant currency, whether in the event of any devaluation, revaluation or imposition of exchange or other regulatory controls or taxes or in the event of other developments affecting that currency, the U.S. dollar or any other currency. Consequently, investors in non-U.S. dollar notes will bear the risk that their investment may be adversely affected by these types of events.

(66) In a lawsuit for payment on a non-U.S. dollar note, you may bear currency exchange risk.

Our notes will be governed by New York law. Under Section 27 of the New York Judiciary Law, a state court in the State of New York rendering a judgment on a note denominated in a currency other than U.S. dollars would be required to render the judgment in the specified currency; however, the judgment would be converted into U.S. dollars at the currency exchange rate prevailing on the date of entry of the judgment. Consequently, in a lawsuit for payment on a note denominated in a currency other than U.S. dollars, investors would bear currency exchange risk until judgment is entered, which could be a long time.

Table of Contents

In courts outside of New York, investors may not be able to obtain judgment in a specified currency other than U.S. dollars. For example, a judgment for money in an action based on a non-U.S. dollar note in many other U.S. federal or state courts ordinarily would be enforced in the United States only in U.S. dollars. The date used to determine the rate of conversion of the currency in which any particular note is denominated into U.S. dollars will depend upon various factors, including which court renders the judgment.

DESCRIPTION OF MEDIUM-TERM NOTES

Clearance and Settlement

Notes we issue may be held through one or more international and domestic clearing systems. The principal clearing systems we will use are the book-entry systems operated by The Deposit Trust Company, or "DTC", in the United States, Clearstream Banking, société anonyme, or Clearstream, Luxembourg, in Luxembourg and Euroclear Bank S.A./N.V., or Euroclear, in Brussels, Belgium. These systems have established electronic securities and payment transfer, processing, depositary and custodial links among themselves and others, either directly or through custodians and depositories. These links allow securities to be issued, held and transferred among the clearing systems without the physical transfer of certificates.

Special procedures to facilitate clearance and settlement have been established among these clearing systems to trade securities across borders in the secondary market. Where payments for notes we issue in global form will be made in U.S. dollars, these procedures can be used for cross-market transfers and the securities will be cleared and settled on a delivery against payment basis.

Global notes will be registered in the name of a nominee for, and accepted for settlement and clearance by, one or more of Euroclear, Clearstream, Luxembourg, DTC and any other clearing system identified in the applicable pricing supplement.

Cross-market transfers of debt securities that are not in global form may be cleared and settled in accordance with other procedures that may be established among the clearing systems for these securities.

Euroclear and Clearstream, Luxembourg hold interests on behalf of their participants through customers' securities accounts in the names of Euroclear and Clearstream, Luxembourg on the books of their respective depositories, which, in the case of securities for which a global note in registered form is deposited with the DTC, in turn hold those interests in customers' securities accounts in the depositories' names on the books of the DTC.

The policies of DTC, Clearstream, Luxembourg and Euroclear will govern payments, transfers, exchange and other matters relating to the investors' interest in securities held by them. This is also true for any other clearance system that may be named in a pricing supplement.

We have no responsibility for any aspect of the actions of DTC, Clearstream, Luxembourg or Euroclear or any of their direct or indirect participants. We have no responsibility for any aspect of the records kept by DTC, Clearstream, Luxembourg or Euroclear or any of their direct or indirect participants. We also do not supervise these systems in any way. This is also true for any other clearing system indicated in a pricing supplement.

DTC, Clearstream, Luxembourg, Euroclear and their participants perform these clearance and settlement functions under agreements they have made with one another or with their customers. Investors should be aware that DTC, Clearstream, Luxembourg, Euroclear and their participants are not obligated to perform these procedures and may modify them or discontinue them at any time.

The description of the clearing systems in this section reflects our understanding of the rules and procedures of DTC, Clearstream, Luxembourg and Euroclear as they are currently in effect. Those systems could change their rules and procedures at any time.

The Clearing Systems

DTC. The following concerning DTC and DTC's book-entry system has been obtained from sources that we believe to be reliable, but we take no responsibility for the accuracy thereof.

Table of Contents

DTC is:

(1) the world's largest securities depository;

(2) a limited purpose trust company organized under the laws of the State of New York;

(3) a "banking organization" within the meaning of New York Banking Law;

(4) a member of the Federal Reserve System;

(5) a "clearing corporation" within the meaning of the New York Uniform Commercial Code; and

(6) a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934.

DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC participants ("DTC direct participants") deposit with DTC. DTC also facilitates the post-trade settlement among DTC direct participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledged between direct participants' accounts, which eliminates the need for physical movement of securities certificates.

DTC is a wholly-owned subsidiary of the Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of DTC direct participants and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation ("NSCC", "FICC", and "EMCC", also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc.

Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a DTC direct participant, either directly or indirectly ("DTC indirect participants").

DTC was created to hold securities for its participants and to facilitate the clearance and settlement of securities transactions between participants through electronic book-entry changes to accounts of its participants. This eliminates the need for physical movement of securities. DTC has Standard & Poor's highest rating: AAA. The rules applicable to DTC and DTC participants are on file with the SEC.

Purchases of notes under the DTC system must be made by or through DTC direct participants, which will receive a credit for the securities on DTC's records. The ownership interest of each actual purchaser of each note ("beneficial owner") is in turn to be recorded on the DTC direct and DTC indirect participants' records. Beneficial owners will not receive written confirmation from DTC of their purchase. Beneficial owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the DTC direct or DTC indirect participant through which the beneficial owner entered into the transaction. Transfers of ownership interests in the securities are to be accomplished by entries made on the books of direct and indirect participants acting on behalf of beneficial owners. Beneficial owners will not receive certificates representing their ownership interests in notes, except in the event that use of the book-entry system for the notes is discontinued.

To facilitate subsequent transfers, all notes deposited by DTC direct participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or any other name as may be requested by an authorized representative of DTC. The deposit of notes with DTC and their registration in the name of Cede & Co. or any other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual beneficial owners of the securities; DTC's records reflect only the identity of the DTC direct participants to whose accounts those notes are credited, which may or may not be the beneficial owners. The DTC direct and DTC indirect participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to DTC direct participants, by DTC direct participants to DTC indirect participants, and by DTC direct

Table of Contents

participants and DTC indirect participants to beneficial owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial owners of securities may wish to take steps to augment the transmission to them of notices of significant events with respect to the securities, such as redemptions, tenders, defaults, and proposed amendments to the security documents. For example, beneficial owners of notes may wish to ascertain that the nominee holding the notes for their benefit has agreed to obtain and transmit notices to beneficial owners. In the alternative, beneficial owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

With respect to the notes that contain an option to redeem, redemption notices shall be sent to DTC. If less than all of the notes within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each DTC direct participant in the issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to securities unless authorized by a DTC direct participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an omnibus proxy to an issuer as soon as possible after the record date. The omnibus proxy assigns Cede & Co.'s consenting or voting rights to those direct participants to whose accounts notes are credited on the record date (identified in a listing attached to the omnibus proxy).

Redemption proceeds, distributions, and dividend payments on the securities will be made to Cede & Co., or any other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit DTC direct participants' accounts upon DTC's receipt of funds and corresponding detail information from issuer or agent, on payable date in accordance with their respective holdings shown on DTC's records. Payments by DTC participants to beneficial owners will be governed by standing instructions and customary practices, as is the case with notes held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of that DTC participant and not of DTC, agent, or us, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or any other nominee as may be requested by an authorized representative of DTC) is the responsibility of issuer or agent, disbursement of those payments to DTC direct participants will be the responsibility of DTC, and disbursement of those payments to the beneficial owners will be the responsibility of DTC direct and DTC indirect participants.

A beneficial owner shall give notice to elect to have its notes purchased or tendered, through its participant, to an agent, and shall effect delivery of those notes by causing the DTC direct participant to transfer the DTC participant's interest in the notes, on DTC's records, to an agent. The requirement for physical delivery of securities in connection with an optional tender or a mandatory purchase will be deemed satisfied when the ownership rights in the notes are transferred by DTC direct participants on DTC's records and followed by a book-entry credit of tendered securities to the agent's DTC account.

DTC may discontinue providing its services as depository with respect to the securities at any time by giving reasonable notice to issuer or agent. Under those circumstances, in the event that a successor depository is not obtained, note certificates are required to be printed and delivered.

We may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, note certificates will be printed and delivered to DTC.

Clearstream, Luxembourg. The following concerning Clearstream, Luxembourg and Clearstream, Luxembourg's book-entry system has been obtained from sources that we believe to be reliable, but we take no responsibility for the accuracy thereof.

Clearstream, Luxembourg is a duly licensed bank organized as a société anonyme incorporated under the laws of Luxembourg and is subject to regulation by the Luxembourg Commission for the Supervision of the Financial Sector (Commission de Surveillance du Secteur Financier).

Table of Contents

Clearstream, Luxembourg holds securities for its customers and facilitates the clearance and settlement of securities transactions among them. It does so through electronic book-entry transfers between the accounts of its customers. This eliminates the need for physical movement of securities.

Clearstream, Luxembourg provides other services to its customers, including safekeeping, administration, clearance and settlement of internationally traded securities and lending and borrowing of securities.

Clearstream, Luxembourg's customers include worldwide securities brokers and dealers, banks, trust companies and clearing corporations and may include professional financial intermediaries. Its U.S. customers are limited to securities brokers and dealers and banks.

Indirect access to the Clearstream, Luxembourg system is also available to others that clear through Clearstream, Luxembourg customers or that have custodial relationships with its customers, such as banks, brokers, dealers and trust companies.

Euroclear. The following concerning Euroclear and Euroclear's book-entry system has been obtained from sources that we believe to be reliable, but we take no responsibility for the accuracy thereof.

Euroclear is incorporated under the laws of Belgium as a bank and is subject to regulation by the Belgian Banking and Finance Commission (Commission Bancaire et Financière) and the National Bank of Belgium (Banque Nationale de Belgique).

Euroclear holds securities for its customers and facilitates the clearance and settlement of securities transactions among them. It does so through simultaneous electronic book-entry delivery against payment, thereby eliminating the need for physical movement of certificates.

Euroclear provides other services to its customers, including credit, custody, lending and borrowing of securities and tri-party collateral management. It interfaces with the domestic markets of several countries.

Euroclear customers include banks, including central banks, securities brokers and dealers, banks, trust companies and clearing corporations and other professional financial intermediaries.

Indirect access to the Euroclear system is also available to others that clear through Euroclear customers or that have custodial relationships with Euroclear customers.

All securities in Euroclear are held on a fungible basis. This means that specific certificates are not matched to specific securities clearance accounts.

Other Clearing Systems. We may choose any other clearing system for the notes. The clearance and settlement procedures for the clearing system we choose will be described in the applicable pricing supplement.

Primary Distribution

The distribution of the notes will be cleared through one or more of the clearing systems that we have described above or any other clearing system that is specified in the applicable pricing supplement. Payment for notes will be made on a delivery versus payment or free delivery basis.

Clearance and settlement procedures may vary from one class of notes to another according to the currency that is chosen for the specific series of notes. Customary clearance and settlement procedures are described below.

We will submit applications to the relevant system or systems for the notes to be accepted for clearance. The clearance numbers that are applicable to each clearance system will be specified in the pricing supplement.

Clearance and Settlement Procedures—DTC. DTC participants that hold debt securities through DTC on behalf of investors will follow the settlement practices applicable to United States corporate debt obligations in DTC's Same-Day Funds Settlement System.

Notes will be credited to the securities custody accounts of these DTC participants against payment in same-day funds, for payments in U.S. dollars, on the settlement date. For payments in a currency other than U.S. dollars, securities will be credited free of payment on the settlement date.

Clearance and Settlement Procedures—Euroclear and Clearstream, Luxembourg. We understand that investors that hold their notes through Euroclear or Clearstream, Luxembourg accounts will follow the settlement procedures that are applicable to conventional Eurobonds in registered form.

Table of Contents

Notes will be credited to the securities custody accounts of Euroclear and Clearstream, Luxembourg participants on the business day following the settlement date, for value on the settlement date. They will be credited either free of payment or against payment for value on the settlement date.

Secondary Market Trading

Trading Between DTC Participants. Secondary market trading between DTC participants will occur in the ordinary way in accordance with DTC's rules. Secondary market trading will be settled using procedures applicable to United States corporate debt obligations in DTC's Same-Day Funds Settlement System.

If payment is made in U.S. dollars, settlement will be in same-day funds. If payment is made in a currency other than U.S. dollars, settlement will be free of payment. If payment is made other than in U.S. Dollars, separate payment arrangements outside of the DTC system must be made between the DTC participants involved.

Trading Between Euroclear and/or Clearstream, Luxembourg Participants. We understand that secondary market trading between Euroclear and/or Clearstream, Luxembourg participants will occur in the ordinary way following the applicable rules and operating procedures of Euroclear and Clearstream, Luxembourg. Secondary market trading will be settled using procedures applicable to conventional Eurobonds in registered form.

Trading Between a DTC Seller and a Euroclear or Clearstream, Luxembourg Purchaser. A purchaser of notes that are held in the account of a DTC participant must send instructions to Euroclear or Clearstream, Luxembourg at least one business day prior to settlement. The instructions will provide for the transfer of the notes from the selling DTC participant's account to the account of the purchasing Euroclear or Clearstream, Luxembourg participant. Euroclear or Clearstream, Luxembourg, as the case may be, will then instruct the common depositary for Euroclear and Clearstream, Luxembourg to receive the securities either against payment or free of payment.

The interests in the notes will be credited to the respective clearing system. The clearing system will then credit the account of the participant, following its usual procedures. Credit for the notes will appear on the next day, European time. Cash debit will be back-valued to, and the interest on the notes will accrue from, the value date, which would be the preceding day, when settlement occurs in New York. If the trade fails and settlement is not completed on the intended date, the Euroclear or Clearstream, Luxembourg cash debit will be valued as of the actual settlement date instead.

Euroclear participants or Clearstream, Luxembourg participants will need the funds necessary to process same-day funds settlement. The most direct means of doing this is to preposition funds for settlement, either from cash or from existing lines of credit, as for any settlement occurring within Euroclear or Clearstream, Luxembourg. Under this approach, participants may take on credit exposure to Euroclear or Clearstream, Luxembourg until the securities are credited to their accounts one business day later.

As an alternative, if Euroclear or Clearstream, Luxembourg has extended a line of credit to them, participants can choose not to pre-position funds and will instead allow that credit line to be drawn upon to finance settlement. Under this procedure, Euroclear participants or Clearstream, Luxembourg participants purchasing securities would incur overdraft charges for one business day (assuming they cleared the overdraft as soon as the securities were credited to their accounts). However, any interest on the notes would accrue from the value date. Therefore, in many cases, the investment income on notes that is earned during that one business day period may substantially reduce or offset the amount of the overdraft charges. This result will, however, depend on each participant's particular cost of funds.

Because the settlement will take place during New York business hours, DTC participants will use their usual procedures to deliver notes to the depositary on behalf of Euroclear participants or Clearstream, Luxembourg participants. The sale proceeds will be available to the DTC seller on the settlement date. For the DTC participants, then, a cross-market transaction will settle no differently than a trade between two DTC participants.

Table of Contents

Special Timing Considerations

You should be aware that you will only be able to make and receive deliveries, payments and other communications involving the notes through Clearstream, Luxembourg and Euroclear on days when those systems are open for business. Those systems may not be open for business on days when banks, brokers and other institutions are open for business in the United States.

In addition, because of time-zone differences, there may be problems with completing transactions involving Clearstream Luxembourg and Euroclear on the same business day as in the United States. U.S. investors who wish to transfer their interests in the notes, or to receive or make a payment or delivery of the notes, on a particular day, may find that the transactions will not be performed until the next business day in Luxembourg or Brussels, depending on whether Clearstream, Luxembourg or Euroclear is used.

Payment and Paying Agent

Currency of Notes

Amounts that become due and payable on your notes in cash will be payable in a currency, composite currency, basket of currencies or currency unit or units ("specified currencies") specified in the applicable pricing supplement. The specified currency for your notes will be U.S. dollars, unless your pricing supplement states otherwise. Some notes may have different specified currencies for principal, interest or other amounts payable in your notes. We will make payments on your notes in the specified currency, except as described in the applicable pricing supplement. See "Risk Factors—Additional Risks Relating to Notes with Reference Assets That Are Currencies or an Index of Currencies" in this prospectus supplement for more information about the risks of investing in this kind of note.

Payments Due in U.S. Dollars

We will follow the practices described below when paying amounts due in U.S. dollars.

Payments on Global Notes. We will make payments on a global note in accordance with the applicable policies of the depositary as in effect from time to time. Under those policies, we will pay directly to the depositary, or its nominee, and not to any indirect owners who own beneficial interests in the global note. An indirect owner's right to receive those payments will be governed by the rules and practices of the depositary and its participants, as described below in the section entitled "Description of Debt Securities—Legal Ownership; Form of Debt Securities" in the accompanying prospectus.

Payments on Non-Global Notes. We will make payments on a note in non-global, registered form as follows. We will pay interest that is due on an interest payment date by check mailed on the interest payment date to the holder at his or her address shown on the trustee's records as of the close of business on the regular record date. We will make all other payments by check at the paying agent described below, against surrender of the note. All payments by check will be made in next-day funds – i.e., funds that become available on the day after the check is cashed. Alternatively, if a non-global note has a face amount of at least $1,000,000 and the holder asks us to do so, we will pay any amount that becomes due on the note by wire transfer of immediately available funds to an account at a bank in New York City, on the due date. To request wire payment, the holder must give the paying agent appropriate wire transfer instructions at least five business days before the requested wire payment is due. In the case of any interest payment due on an interest payment date, the instructions must be given by the person or entity who is the holder on the relevant regular record date. In the case of any other payment, payment will be made only after the note is surrendered to the paying agent. Any wire instructions, once properly given, will remain in effect unless and until new instructions are given in the manner described above.

Book-entry and other indirect owners should consult their banks or brokers for information on how they will receive payments on their notes.

For a description of the paying agent, see "Description of Debt Securities—Legal Ownership; Form of Debt Securities—Payment and Paying Agents" in the accompanying prospectus.

Table of Contents

Payments Due in Non-U.S. Dollar Currencies

We will follow the practices described below when paying amounts that are due in a specified currency other than U.S. dollars.

Payments on Global Notes. We will make payments on a global note in accordance with the applicable policies of the depositary as in effect from time to time. We understand that these policies, as currently in effect at Depositary Trust Company, or DTC, are as follows:

Unless otherwise indicated in your pricing supplement, if you are an indirect owner of global notes denominated in a specified currency other than U.S. dollars you will not have the right to elect to receive payment in that other currency. If your pricing supplement indicates that you have the right to elect to receive payments in that other currency and you do make that election, you must notify the participant through which your interest in the global note is held of your election:

- on or before the applicable regular record date, which shall be specified in your pricing supplement, in the case of a payment of interest, or
- on or before the 16th day prior to stated maturity, or any redemption or repayment date, in the case of payment of principal or any premium.

If any interest, principal or premium payment is due in a specified currency other than U.S. dollars, you may elect to receive all or only a portion of the payment in that other currency.

Your participant must, in turn, notify DTC of your election on or before the third DTC business day after that regular record date, in the case of a payment of interest, and on or before the 12th DTC business day prior to stated maturity, or on the redemption or repayment date if your note is redeemed or repaid earlier, in the case of a payment of principal or any premium.

DTC, in turn, will notify the paying agent of your election in accordance with DTC's procedures.

If complete instructions are received by the participant and forwarded by the participant to DTC, and by DTC to the paying agent, on or before the dates noted above, the paying agent, in accordance with DTC's instructions, will make the payments to you or your participant by wire transfer of immediately available funds to an account maintained by you or your participant with a bank located in the country issuing the specified currency or in another jurisdiction acceptable to us and the paying agent.

If the foregoing steps are not properly completed, we expect DTC to inform the paying agent that payment is to be made in U.S. dollars. In that case, we or our agent will convert the payment to U.S. dollars in the manner described below under "—Payment and Paying Agents—Payments Due in Non-U.S. Dollar Currencies—Conversion to U.S. Dollars". We expect that we or our agent will then make the payment in U.S. dollars to DTC, and that DTC in turn will pass it along to its participants.

Book-entry and other indirect holders of a global note denominated in a currency other than U.S. dollars should consult their banks or brokers for information on how to request payment in the specified currency.

Payments on Non-Global Notes. Except where otherwise requested by the holder as described below, we will make payments on notes in non-global form in the applicable specified currency. We will make these payments by wire transfer of immediately available funds to any account that is maintained in the applicable specified currency at a bank designated by the holder and is acceptable to us and the trustee. To designate an account for wire payment, the holder must give the paying agent appropriate wire instructions at least five business days before the requested wire payment is due. In the case of any interest payment due on an interest payment date, the instructions must be given by the person who is the holder on the regular record date. In the case of any other payment, the payment will be made only after the note is surrendered to the paying agent. Any instructions, once properly given, will remain in effect unless and until new instructions are properly given in the manner described above.

If a holder fails to give instructions as described above, we will notify the holder at the address in the trustee's records and will make the payment within five business days after the holder provides appropriate instructions. Any late payment made in these circumstances will be treated under the senior debt indenture as if made on the due date, and no interest will accrue on the late payment from the due date to the date paid.

Table of Contents

Although a payment on a note in non-global form may be due in a specified currency other than U.S. dollars, we will make the payment in U.S. dollars if the holder asks us to do so. To request U.S. dollar payment, the holder must provide appropriate written notice to the paying agent at least five business days before the next due date for which payment in U.S. dollars is requested. In the case of any interest payment due on an interest payment date, the request must be made by the person who is the holder on the regular record date. Any request, once properly made, will remain in effect unless and until revoked by notice properly given in the manner described above.

Indirect owners of a non-global note with a specified currency other than U.S. dollars should contact their banks or brokers for information about how to receive payments in the specified currency or in U.S. dollars.

Conversion to U.S. Dollars. When we make payments in U.S. dollars of an amount due in another currency, either on a global note or a non-global note as described above, we will determine the U.S. dollar amount the holder receives as follows. The exchange rate agent described below will request currency bid quotations expressed in U.S. dollars from three or, if three are not available, then two, recognized foreign exchange dealers in New York City, any of which may be the exchange rate agent, which may be Barclays Capital Inc., an affiliate of Barclays Bank PLC, as of 11:00 a.m., New York City time, on the second business day before the payment date.

Currency bid quotations will be requested on an aggregate basis, for all holders of notes requesting U.S. dollar payments of amounts due on the same date in the same specified currency. The U.S. dollar amount the holder receives will be based on the highest acceptable currency bid quotation received by the exchange rate agent. If the exchange rate agent determines that at least two acceptable currency bid quotations are not available on that second business day, the payment will be made in the specified currency.

To be acceptable, a quotation must be given as of 11:00 a.m., New York City time, on the second business day before the due date and the quoting dealer must commit to execute a contract at the quotation in the total amount due in that currency on all series of notes. (If some but not all of the relevant notes are LIBOR notes or EURIBOR notes, the second preceding business day will be determined for this purpose as if none of those notes were LIBOR notes or EURIBOR notes.)

When we make payments to you in U.S. dollars of an amount due in another currency, you will bear all associated currency exchange costs, which will be deducted from the payment.

When the Specified Currency Is Not Available. If we are obligated to make any payment in a specified currency other than U.S. dollars, and the specified currency or any successor currency is not available to us or cannot be paid to you due to circumstances beyond our control – such as the imposition of exchange controls or a disruption in the currency markets – we will be entitled to satisfy our obligation to make the payment in that specified currency by making the payment in U.S. dollars, on the basis specified in the applicable pricing supplement.

For a specified currency other than U.S. dollars, the currency exchange rate will be the noon buying rate for cable transfers of the specified currency in New York City as quoted by the Federal Reserve Bank of New York on the then-most recent day on which that bank has quoted that rate.

The foregoing will apply to any note, whether in global or non-global form, and to any payment, including a payment at maturity. Any payment made under the circumstances and in a manner described above will not result in a default under any note or the senior debt indenture.

Exchange Rate Agent. If we issue a note in a specified currency other than U.S. dollars, we will appoint a financial institution to act as the exchange rate agent and will name the institution initially appointed when the note is originally issued in the applicable pricing supplement. We may select Barclays Capital Inc. or another of our affiliates to perform this role. We may change the exchange rate agent from time to time after the original issue date of the note without your consent and without notifying you of the change.

Table of Contents

All determinations made by the exchange rate agent will be at its sole discretion unless we state in your pricing supplement that any determination is subject to our approval. In the absence of manifest error, those determinations will be conclusive for all purposes and final and binding on you and us, without any liability on the part of the exchange rate agent.

Calculations and Calculation Agent

Any calculations relating to the notes will be made by the calculation agent, an institution that we appoint as our agent for this purpose. Unless otherwise specified in the applicable pricing supplement, Barclays Bank PLC will act as calculation agent. We may appoint a different institution, including one of our affiliates, to serve as calculation agent from time to time after the original issue date of the note without your consent and without notifying you of the change.

The calculation agent will, in its sole discretion, make all determinations regarding the market value of the notes at maturity, the price, value or level of the reference asset, market disruption events, business days, the default amount upon any acceleration (only in the case of a market disruption event), the maturity date, any early redemption date, the interest rate and the amount payable in respect of your notes and any other calculations or determinations to be made by the calculation agent. Absent manifest error, all determinations of the calculation agent will be conclusive for all purposes and final and binding on you and us, without any liability on the part of the calculation agent. If the calculation agent is Barclays Bank PLC or an affiliate of Barclays Bank PLC, the calculation agent is obligated to carry out its duties and functions as calculation agent in good faith and using reasonable judgment. If the calculation agent uses its discretion to make a determination, the calculation agent will notify the trustee who will, to the extent it is required to under the senior debt indenture, notify each holder, or in the case of global notes, the depositary, as holder of the global notes. You will not be entitled to any compensation from us for any loss suffered as a result of any of the above determinations by the calculation agent.

All percentages resulting from any calculation relating to a note will be rounded upward or downward, as appropriate, to the next higher or lower one hundred-thousandth of a percentage point, e.g., 9.876541% (or .09876541) being rounded down to 9.87654% (or .0987654) and 9.876545% (or .09876545) being rounded up to 9.87655% (or .0987655). All amounts used in or resulting from any calculation relating to a note will be rounded upward or downward, as appropriate, to the nearest cent, in the case of U.S. dollars, the nearest corresponding hundredth of a unit, in the case of a currency other than U.S. dollars, or to the nearest one hundred-thousandth of a unit, in the case of a currency exchange rate, with one-half cent, one-half of a corresponding hundredth of a unit or one-half of a hundred-thousandth of a unit or more being rounded upward.

In determining the price, value or level of a reference asset that applies to a note during a particular interest or other period, the calculation agent may obtain quotes from various banks or dealers active in the relevant market, as described under “Reference Assets” below. Those reference banks, dealers, reference asset sponsors or information providers may include the calculation agent itself and its affiliates, as well as any underwriter, dealer or agent participating in the distribution of the relevant notes and its affiliates, and they may include Barclays Bank PLC or its affiliates.

The Pricing Supplement

The pricing supplement for each offering of notes will contain the detailed information and terms for that particular offering. The pricing supplement also may add, update or change information contained in the applicable product supplement, if any, this prospectus supplement and the prospectus. If any information in the pricing supplement is inconsistent with the applicable product supplement, this prospectus supplement or the prospectus, you should rely on the information in the pricing supplement. Any pricing supplement should be read in connection with this prospectus supplement and the prospectus. It is important that you consider all of the information in the pricing supplement, this prospectus supplement and the prospectus when making your investment decision.

Table of Contents

Terms Specified in a Pricing Supplement

The following contains a partial listing of the information and terms of a note offering which may be included in a pricing supplement:

- initial public offering price,
- the reference asset and a description thereof,
- to the extent that the reference asset is an index, a description of the components thereof,
- ticker symbol or other identification of the reference asset,
- stated principal amount,
- the initial valuation date or other date on which the notes price,
- settlement date and original issue date,
- valuation dates, observation dates or averaging dates, if any,
- maturity date and any terms related to any extension of the maturity date not otherwise set forth in this prospectus supplement,
- agents' commission or discount, if any,
- to the extent the reference asset is based on multiple indices, the relative weighting of each index comprising the reference asset,
- maximum return, if any,
- maximum loss, if any, provided that in some instances, the maximum loss will be determined based on a formula or other method as described in the applicable pricing supplement,
- initial level, value or price of the reference asset,
- whether your principal investment in the notes is fully protected, partially protected, contingently protected or not protected,
- upside leverage factor or participation rate, if any,
- downside leverage factor, if any,
- barrier percentage or barrier level, if any,
- buffer percentage or buffer level, if any,
- payment at maturity, including the formula or method of calculation and the relevant reference assets, if any,
- to the extent the notes are exchangeable for reference assets, the specified property or the cash value of the specified property the holder may receive at the specified currency exchange rate, at maturity or otherwise,
- business day, business day convention and day count convention,
- CUSIP number,
- over-allotment option, if any,
- reissuances or reopened issues of the notes,
- denominations of the notes,
- issue price and variable price offer,
- early redemption option, option redemption dates, redemption price, if any,
- repayment at the option of the note holder, if any,
- special requirements for optional repayment of global notes, if any,
- the specified currency and the currency in which the interest will be payable if not U.S. dollars,
- whether or not the notes will be listed,
- for notes that pay interest, information concerning the related fixed or floating rate, any spread and any other terms relating to the particular method of calculating the interest rate for the note, and
- any other applicable terms.

TERMS OF THE NOTES

Please note that the information about the price to the public and net proceeds to Barclays Bank PLC in the applicable pricing supplement relates only to the initial sale of the notes. If you have purchased the notes in a purchase/resale transaction after the initial sale, information about the price and date of sale to you will be provided in a separate confirmation of sale.

Table of Contents

We describe the terms of the notes in more detail below.

To the extent the amounts payable on the notes are based on a reference asset or formula other than the rates or formulas described in this prospectus supplement, the terms of this prospectus supplement will be amended in the applicable pricing supplement to account for such reference asset or formula.

Principal Protection

The applicable pricing supplement will specify whether your principal investment in the notes is fully protected, partially protected, contingently protected or not protected. If your notes are contingently protected, the applicable pricing supplement will specify the "buffer level", "buffer percentage" or "protection price" described below. If your principal investment is not principal protected, you may receive less, and possibly significantly less, than the amount you invested.

Payment at Maturity

The applicable pricing supplement will detail the payment at maturity. The payment at maturity may be based on movements in the price, value or level or other events relating to one or more reference assets, and if so, the formula or method of calculation and the relevant reference assets will be specified in the applicable pricing supplement.

Interest

The notes will bear interest, if any, from the original issue date or any other date as specified in the applicable pricing supplement at either a fixed-rate, floating-rate or linked to a reference asset as specified in the applicable pricing supplement. See "Interest Mechanics". Some notes may not bear interest as specified in the applicable pricing supplement.

Exchangeable Notes

An exchangeable note is a note that is optionally or mandatorily exchangeable into cash or one or more reference assets. A note of this type may or may not bear interest or be issued with original discount or at a premium. See "Certain Features of the Notes—Exchangeable Notes" below.

Original Issue Discount Notes

A note may be an original issue discount note. A note of this type generally is issued at a price lower than its principal amount and generally provides that, upon redemption or acceleration of its maturity, an amount less than its principal amount will be payable. An original issue discount note may be a zero coupon note. See "Certain U.S. Federal Income Tax Considerations" for a description of the U.S. federal income tax consequences of owning an original issue discount note.

Issue Price and Variable Price Offer

The notes may have a fixed price (such as par) or a "variable price offer" where the notes are sold in one or more negotiated transactions (at prices that may be different than par), and these sales may occur at market prices prevailing at the time of sale, at prices related to those prevailing market prices or at negotiated prices. The notes may be sold at a discount and the redemption price may equal 100% or some other percentage of par. The applicable pricing supplement will specify the issue price or the maximum issue price.

Maturity Date

The maturity date will be the maturity date specified in the applicable pricing supplement. Unless otherwise stated therein, the maturity date will be governed by the "following business day" convention (e.g., if the maturity date stated in the applicable pricing supplement is not a business day, the maturity date will be extended to the next following business day). If the final valuation date referred to below occurs on a day which is less than two business days prior to the maturity date, then the maturity date will be the second business day following that date. The calculation agent may postpone the final valuation date –and therefore the maturity date – if a market disruption event occurs or is continuing on a day that would otherwise be the final valuation date. We describe market disruption events for the different reference asset classes under "Reference Assets". See "Certain Features of the Notes—Final Valuation Date, Final Observation Date or Final Averaging Date" and "—Final Observation Date or Final Averaging Date".

Table of Contents

In the event that the maturity date is postponed as described above, the related payment of interest, and other amounts payable on the notes at maturity without additional interest will be made on the postponed maturity date.

Reissuances or Reopened Issues

Under some limited circumstances, and at our sole discretion, we may "reopen" or reissue certain issuances of notes. These further issuances, if any, will be consolidated to form a single class with the originally issued notes and will have the same CUSIP number and will trade interchangeably with the notes immediately upon settlement. Any additional issuances will increase the aggregate principal amount of the outstanding notes of the class, plus the aggregate principal amount of any notes bearing the same CUSIP number that are issued pursuant to (i) any over-allotment option we may grant to an agent, and (ii) any future issuances of notes bearing the same CUSIP number. The price of any additional offering will be determined at the time of pricing of that offering.

We intend to comply with the requirements under the Treasury regulations governing "qualified reopenings" and we will therefore treat any additional offerings of notes as part of the same issue as the notes for U.S. federal income tax purposes. Accordingly, for purposes of the Treasury regulations governing original issue discount on debt instruments, we will treat any additional offerings of notes as having the same original issue date, the same issue price and, with respect to holders, the same adjusted issue price as the notes.

Over-Allotment Option

We grant agents a 30-day over-allotment option from the date of the applicable pricing supplement to purchase or arrange for purchase from us additional principal amount of notes at the public offering price to cover any over-allotments.

Business Day

A "business day" with respect to the notes will be defined in the applicable pricing supplement according to a specified business day convention. See "—Business Day Convention" below.

As used in this prospectus supplement with respect to the reference assets which are interest rates, "business day" means any day that:

- for any note, is a Monday, Tuesday, Wednesday, Thursday or Friday and that is not a day on which banking institutions in New York City generally are authorized or obligated by law or executive order to be closed,
- for LIBOR notes only, is also a London business day,
- for notes having a specified currency other than U.S. dollars only, other than notes denominated in Euros, is also not a day on which banking institutions in the principal financial center (as described below) of the country of the specified currency generally are authorized or obligated by law or executive order to close, and
- for EURIBOR notes, notes denominated in Euros or LIBOR notes for which the index currency is Euros only, is also a Euro business day.

As used above, a principal financial center means the capital city of the country issuing the specified currency. However, for U.S. dollars, Australian dollars, Canadian dollars and Swiss francs, the principal financial center will be New York City, Sydney, Toronto and Zurich, respectively.

As used in this prospectus supplement, a "London business day" means any day that is a Monday, Tuesday, Wednesday, Thursday or Friday and on which dealings in deposits in U.S. dollars are transacted, or with respect to any future date are expected to be transacted, in the London interbank market, and a "Euro business day" means any day that is a Monday, Tuesday, Wednesday, Thursday or Friday on which the Trans-European Automated Real-Time Gross Settlement Express Transfer System is open.

Table of Contents

Business Day Convention

Business day conventions are procedures used to adjust certain dates (e.g., interest payment dates, redemption dates, etc.) in response to days that are not business days. The descriptions below use payment dates for example purposes.

Following Business Day. Any payment on the notes that would otherwise be due on a day that is not a business day may instead be paid on the next day that is a business day.

Modified Following Business Day. Any payment on the notes that would otherwise be due on a day that is not a business day may instead be paid on the next day that is a business day, unless that day falls in the next calendar month, in which case the payment date will be the first preceding day that is a business day.

Preceding Business Day. Any payment on the notes that would otherwise be due on a day that is not a business day may instead be paid on the first preceding day that is a business day.

In each case, if a payment is made on the following or preceding business day in accordance with the procedures described above with the same effect as if paid on the original due date and without payment of any additional interest, the business day convention is "unadjusted".

Day Count Convention

A day count convention is a method to calculate the fraction of a year between two dates. The applicable pricing supplement will specify the day count convention, if any.

ACT/360 or Actual/360. The actual number of days between two periods divided by 360.

30/360. Each month is treated as having 30 days and the year is considered to have 360 days.

ACT/ACT or Actual/Actual. Each month represents the actual number of days divided by the actual number of days in the year.

ACT/365 or Actual/365 Fixed. Each month represents the actual number of days, and the year is assumed to have 365 days, regardless of leap year status.

NL/365. "No Leap Year" logic extension to ACT/365 where leap days are subtracted, ensuring the quotient never exceeds 1.

30/365. Extension to 30/360 where each month is treated as having 30 days and the year is considered to have 365 days.

ACT/366 or Actual/366. Extension to ACT/365 where each month represents the actual number of days and the denominator is set to 366, ensuring the quotient never exceeds 1.

ACT/252 or BUS/252 or Actual/252 or Business Days/252. The number of business days in a nominal year of 252 business days. (Weekends and holidays are excluded; thus, Friday to Monday would be considered 1 day.)

Redemption and Repurchase

Early Redemption Option

The applicable pricing supplement will indicate the terms of the option, if any, we have to redeem the notes, in whole or in part. We will notify each holder, or in the case of global notes, the depositary, as holder of the global notes within the redemption notice period specified in the applicable pricing supplement. The notes will not be subject to any sinking fund. See "Description of Debt Securities—Redemption" in the accompanying prospectus.

Optional Redemption Dates

We, at our election, may redeem the notes in whole or in part on any optional redemption date. The applicable pricing supplement will indicate the optional redemption dates and the respective business day convention.

Redemption Price

If we exercise any early redemption option we have, we will pay you the "redemption price" which is the price per note, together with any accrued but unpaid interest thereon to (but excluding) the early redemption date.

Unless stated otherwise in the applicable pricing supplement, the early redemption date will be governed by the "following business day" convention and interest will not accrue during the period from and after the stated early redemption date. See "Terms of the Notes—Business Day Convention".

Table of Contents

Repayment at Option of the Holder

The applicable pricing supplement will indicate whether the holder has the option to require us to repay the note on a date or dates specified prior to its maturity date. The repayment price will be disclosed in the applicable pricing supplement. If the notes were issued with original issue discount, the applicable pricing supplement will specify the amount payable upon repayment.

Exercise of the repayment option by the holder of a note will be irrevocable. The holder may exercise the repayment option for less than the entire principal amount of the note but, in that event, the principal amount of the note remaining outstanding after repayment must be an authorized denomination.

Special Requirements for Optional Repayment of Global Notes

Since the notes are represented by global notes, the depositary or depositary's nominee will be the holder of the notes and therefore will be the only entity that can exercise a right to repayment. To ensure that the depositary's nominee will timely exercise a right to repayment of a particular note, the beneficial owner of the note must instruct the broker or other direct or indirect participant through which it holds an interest in the note to notify the depositary of its desire to exercise a right to repayment. Each beneficial owner of the note should consult the broker or other direct or indirect participant through which it holds an interest in a note in order to ascertain the cut-off time by which an instruction must be given for timely notice to be delivered to the depositary.

Default Amount on Acceleration

If an event of default occurs and the maturity of the notes is accelerated, we will pay the default amount in respect of the principal of the notes at maturity. We describe the default amount below under "Terms of the Notes—Default Amount on Acceleration—Default Amount".

For the purpose of determining whether the holders of our medium-term notes, of which the notes are a part, are entitled to take any action under the senior debt indenture, we will treat the stated principal amount of each note outstanding as the principal amount of that note. Although the terms of the notes may differ from those of the other medium-term notes, holders of specified percentages in principal amount of all medium-term notes, together in some cases with other series of our debt securities, will be able to take action affecting all the medium-term notes, including the notes. This action may involve changing some of the terms that apply to the medium-term notes, accelerating the maturity of the medium-term notes after a default or waiving some of our obligations under the senior debt indenture. We discuss these matters in the attached prospectus under "Description of Debt Securities—Modification and Waiver" and "—Senior Events of Default; Subordinated Events of Default and Defaults; Limitations of Remedies".

Default Amount

The default amount for the notes on any day will be an amount, in U.S. dollars for the principal of the notes, equal to the cost of having a qualified financial institution, of the kind and selected as described below, expressly assume all our payment and other obligations with respect to the notes as of that day and as if no default or acceleration had occurred, or to undertake other obligations providing substantially equivalent economic value to you with respect to the notes. That cost will equal:

- the lowest amount that a qualified financial institution would charge to effect this assumption or undertaking, plus
- the reasonable expenses, including reasonable attorneys' fees, incurred by the holders of the notes in preparing any documentation necessary for this assumption or undertaking.

During the default quotation period for the notes, which we describe below, the holders of the notes and/or we may request a qualified financial institution to provide a quotation of the amount it would charge to effect this assumption or undertaking. If either party obtains a quotation, it must notify the other party in writing of the quotation. The amount referred to in the first bullet point above will equal the lowest – or, if there is only one, the only – quotation obtained, and as to which notice is so given, during the default quotation period. With respect to any quotation, however, the party not obtaining the quotation may object, on

Table of Contents

reasonable and significant grounds, to the assumption or undertaking by the qualified financial institution providing the quotation and notify the other party in writing of those grounds within two business days after the last day of the default quotation period, in which case that quotation will be disregarded in determining the default amount.

Default Quotation Period

The default quotation period is the period beginning on the day the default amount first becomes due and ending on the third business day after that day, unless:

- no quotation of the kind referred to above is obtained, or
- every quotation of that kind obtained is objected to within five business days after the due date as described above.

If either of these two events occurs, the default quotation period will continue until the third business day after the first business day on which prompt notice of a quotation is given as described above. If that quotation is objected to as described above within five business days after that first business day, however, the default quotation period will continue as described in the prior sentence and this sentence.

In any event, if the default quotation period and the subsequent two business day objection period have not ended before the final valuation date, then the default amount will equal the principal amount of the notes.

Qualified Financial Institutions

For the purpose of determining the default amount at any time, a qualified financial institution must be a financial institution organized under the laws of any jurisdiction in the United States or Europe, which at that time has outstanding debt obligations with a stated maturity of one year or less from the date of issue and rated either:

- A-1 or higher by Standard & Poor's, a division of The McGraw-Hill Companies, Inc., or any successor, or any other comparable rating then used by that rating agency, or
- P-1 or higher by Moody's Investors Service, Inc. or any successor, or any other comparable rating then used by that rating agency.

INTEREST MECHANICS

How Interest Is Calculated

Interest on notes will accrue from and including the most recent interest payment date to which interest has been paid or duly provided for, or, if no interest has been paid or duly provided for, from and including the original issue date or any other date specified in a pricing supplement on which interest begins to accrue. Interest will accrue to but excluding the next interest payment date or, the date on which the principal has been paid or duly made available for payment, except as described under "—If a Payment Date Is Not a Business Day" herein.

Accrued interest on a floating rate note during an interest period with more than one interest reset date will be calculated by multiplying the principal amount of the note by an accrued interest factor. The accrued interest factor will be computed by adding the interest factors calculated for each day in the applicable interest period. Unless otherwise specified in the applicable pricing supplement, the interest factor for each such day will be computed by dividing the interest rate in effect on that day by 360, in the case of CD rate notes, commercial paper rate notes, federal funds rate notes, LIBOR notes, EURIBOR notes, prime rate notes, eleventh district cost of funds rate notes and CMS rate notes. In the case of CMT rate notes and Treasury rate notes, the interest factor for each such day will be computed by dividing the interest rate by the actual number of days in the year. The interest factor will be expressed as a decimal calculated to seven decimal places without rounding. For purposes of making the foregoing calculation, the interest rate in effect on any interest reset date will be the applicable rate as reset on that date.

For all other floating rate notes, accrued interest will be calculated by multiplying the principal amount of the note by the interest rate in effect during the applicable interest period. That product is then multiplied by the quotient obtained by dividing the actual number of days in the period for which accrued interest is being calculated by 360, in the case of CD rate notes,

Table of Contents

commercial paper rate notes, federal funds rate notes, LIBOR notes, EURIBOR notes, prime rate notes, eleventh district cost of funds rate notes and CMS rate notes. In the case of CMT notes and Treasury rate notes, the product is multiplied by the quotient obtained by dividing the actual number of days in the period for which accrued interest is being calculated by the actual number of days in the year.

Regular Record Dates for Interest

Global Notes

In the event that the notes are issued as "global notes", the ultimate beneficial owners of the notes are indirect holders and interest will be paid to the person in whose name the notes are registered at the close of business on the regular record date before each interest payment date. The regular record date relating to an interest payment date for the notes issued as "global notes" will be the date one business day prior to the interest payment date, whether or not that interest payment date is a business day; provided *that* for an interest payment date that is also the maturity date, the interest payable on that interest payment date will be payable to the person to whom the principal is payable. If the interest payment date is also a day on which principal is due, the interest payable will include interest accrued to, but excluding, the maturity date. If a note is issued between a record date and an interest payment date, the first interest payment will be made on the next succeeding interest payment date. For the purpose of determining the holder at the close of business on a regular record date, the close of business will mean 5:00 p.m., New York City time, on that day. See "Description of Debt Securities—Legal Ownership; Form of Debt Securities" in the accompanying prospectus.

Non-Global Notes

The regular record date relating to an interest payment date for the notes issued in non-global, registered form will be the date 15 business days prior to the interest payment date, whether or not that interest payment date is a business day; provided *that* for an interest payment date that is also the maturity date, the interest payable on that interest payment date will be payable to the person to whom the principal is payable. If the interest payment date is also a day on which principal is due, the interest payable will include interest accrued to, but excluding, the maturity date. If a note is issued between a record date and an interest payment date, the first interest payment will be made on the next succeeding interest payment date. For the purpose of determining the holder at the close of business on a regular record date, the close of business will mean 5:00 p.m., New York City time, on that day. See "Description of Debt Securities—Legal Ownership; Form of Debt Securities" in the accompanying prospectus.

If a Payment Date Is Not a Business Day

If any scheduled interest payment date, maturity date or any earlier redemption or repayment date, is not a business day, we may pay interest or principal according to a designated business day convention, which may be the same for all of those dates or different for each date. See "Terms of the Notes—Business Day Convention". Interest on that payment may or may not accrue during the period from and after the scheduled or stated payment date. Unless the applicable pricing supplement states otherwise, we will pay interest or principal according to the following business day convention, unadjusted (i.e., interest on that payment will not accrue during the period from and after the scheduled date).

No interest will accrue and be payable on your notes after the maturity date specified in the applicable pricing supplement if the maturity date is postponed or extended.

Interest Payment Dates or Coupon Payment Dates

Subject to adjustment in accordance with the business day convention, the "interest payment dates" or "coupon payment dates" are the dates payments of interest on notes will be made. The interest payment dates will be specified in the applicable pricing supplement. See "Terms of the Notes—Interest" and "Interest Mechanics—Regular Record Dates for Interest" in this prospectus supplement and "Description of Debt Securities—Legal Ownership; Form of Debt Securities" in the accompanying prospectus.

How Floating Interest Rates Are Reset

The interest rate in effect from the date of issue to the first interest reset date for a floating rate note will be the initial interest rate specified in

Table of Contents

the applicable pricing supplement. We refer to this rate as the "initial interest rate". The interest rate on each floating rate note may be reset daily, weekly, monthly, quarterly, semi-annually or annually. This period is the "interest reset period" and the first day of each interest reset period is the "interest reset date".

Unless otherwise specified in the applicable pricing supplement, if an interest reset date for any floating rate note (other than a LIBOR note, EURIBOR note or federal funds rate note) would fall on a day that is not a business day, the interest reset date will be postponed to the next following business day. If an interest reset date for a LIBOR note would fall on a day that is not a London business day, the interest reset date will be postponed to the next modified following London business day. If an interest reset date for a EURIBOR note would fall on a day that is not a Euro business day, the interest reset date will be postponed to the next modified following Euro business day. If an interest reset date, in the case of a federal funds (open) rate note or a federal funds (effective) rate note, would fall on a day that is not a business day, the interest reset date will be postponed to the next modified following business day. If an auction of direct obligations of U.S. Treasury bills falls on a day that is an interest reset date for treasury rate notes, the interest reset date will be the following business day.

The rate of interest that goes into effect on any interest reset date will be determined by the calculation agent by reference to a particular date called an "interest determination date". Unless otherwise specified in the applicable pricing supplement:

- For federal funds (open) rate notes, the interest determination date relating to a particular interest reset date will be the same day as the interest reset date.
- For prime rate notes and federal funds (effective) rate notes, the interest determination date relating to a particular interest reset date will be the first business day preceding the interest reset date.
- For commercial paper rate notes, CD rate notes, CMS rate notes and CMT rate notes, the interest determination date relating to a particular interest reset date will be the second business day preceding the interest reset date.
- For LIBOR notes, the interest determination date relating to a particular interest reset date will be the second London business day before the interest reset date, unless the index currency is pounds sterling, in which case the interest determination date will be the interest reset date.
- For EURIBOR notes, the interest determination date relating to a particular interest reset date will be the second Euro business day preceding the interest reset date.
- For treasury rate notes, the interest determination date for a particular interest reset date will be the day of the week in which the interest reset date falls on which treasury securities would normally be auctioned. Treasury securities are normally sold at auction on Monday of each week unless that day is a legal holiday. In that case the auction is normally held on the following Tuesday, except that the auction may be held on the preceding Friday. If, as the result of a legal holiday, an auction is held on the preceding Friday, that Friday will be the treasury rate interest determination date pertaining to the interest reset date falling in the next week. If an auction date falls on any day that would otherwise be an interest reset date for a treasury rate note, then that interest reset date will instead be the business day immediately following the auction date.
- For eleventh district cost of funds rate notes, the interest determination date relating to a particular interest reset date will be the last working day, in the first calendar month before that interest reset date, on which the Federal Home Loan Bank of San Francisco publishes the monthly average cost of funds paid by a member institutions of the Eleventh Federal Home Loan Bank District for the second calendar month before that interest reset date.

The "index maturity" for any floating rate note is the period of maturity of the instrument or obligation from which the reference asset or base rate is calculated.

Table of Contents

CERTAIN FEATURES OF THE NOTES

To the extent the amounts payable on the notes are based on a reference asset or formula other than the rates or formulas described in this prospectus supplement, the terms of this prospectus supplement will be amended in the applicable pricing supplement to account for such reference asset or formula.

Your notes may incorporate several or none of these features or additional features which will be specified in the applicable pricing supplement.

Bull Notes

"Bull notes" are offerings where the payment at maturity and/or interest payments are linked to the increase in the level, value or price of the reference asset. Unless otherwise specified in the applicable pricing supplement, the notes will be bull notes.

Bear Notes

"Bear notes" are offerings where the payment at maturity and/or interest payments are linked to the decrease in the level, value or price of the reference asset.

Rate Cut-off

The "rate cut-off period" is the specified period during which interest accrues on the notes immediately prior to an interest payment date, to but excluding the interest payment date. The reference asset for purposes of determining the amount payable for each day during the rate-cut-off period will be set a specified number of business days prior to the related interest payment date using the applicable interest rate immediately preceding the start of the rate cut-off period, and will remain in effect until the related interest payment date.

Coupon Conversion Right

A "coupon conversion right" will allow us to elect to convert all of your notes on a "conversion date" so that instead of accruing interest, the notes will pay interest periodically at the interest rate on each interest payment date following the conversion date.

Digital Notes

Whether interest, principal or other amount is payable on "digital notes" depends on whether the reference asset has achieved certain levels, values or prices set forth in the applicable pricing supplement, however, the amount of the payments, if any, may or may not be dependent on the reference asset. For example, if the final price of the reference asset is greater than the initial price of the reference asset, the interest payment you receive with respect to the notes and the principal payment you receive at maturity will be a fixed amount and not reflect the performance of the reference asset. Under no circumstances, regardless of the extent to which the value of the reference asset appreciates, will your return exceed the applicable interest rate. In this example, if the reference asset has appreciated by 50% as of the final valuation date, you will receive only your principal amount plus the applicable interest payments made at maturity of the notes. You may earn significantly less by investing in digital notes than you would have earned by investing directly in the reference asset.

Inverse Floating Rates

Any floating rate may be designated in the applicable pricing supplement as an inverse floating rate. In that case, unless otherwise specified in the applicable pricing supplement, the interest rate on the floating rate Note will be equal to:

- (a) the initial interest rate or another fixed rate of interest specified in the applicable pricing supplement for the period commencing on the original issue date, or the date on which the Note otherwise begins to accrue interest if different from the original issue date, up to the first interest reset date; and
- (b) a fixed rate of interest specified in the applicable pricing supplement minus the interest rate determined by the reference rate(s) as adjusted by any multiplier for the period commencing on an interest reset date.

Commencing on the first interest reset date, the rate at which interest on the inverse floating rate Note is payable will be reset as of each interest reset date.

Table of Contents

The interest rate will be determined in accordance with the applicable provisions below. The interest rate in effect on each day will be based on:

- if the day is an interest reset date, the interest rate determined as of the interest determination date immediately preceding the applicable interest reset date; or
- if the day is not in interest reset date, the interest rate determined as of the interest determination date immediately preceding the most recent interest reset date.

Maximum Return, Maximum Rate, Ceiling or Cap

The principal, interest or any other amounts payable on the notes may be subject to a “maximum return”, “maximum rate”, “ceiling” or a “cap” limiting the rate of return or interest, which may accrue during the term of the notes or during any interest payment period.

Minimum Rate or Floor

The principal, interest or any other amounts payable on the notes may be subject to a “minimum rate” or “floor” guaranteeing a minimum rate of return or interest, which may accrue during the term of the notes or during any interest payment period.

Spread

The “spread” is the number of basis points (where one basis point equals one one-hundredth of a percentage point) which may be specified in the applicable pricing supplement to be added to or subtracted from the reference asset value or other formula. The spread may also be expressed as a percentage where one percentage point is 100 basis points.

Multiplier

The “multiplier” is the number of basis points or percentage points which may be specified in the applicable pricing supplement to be multiplied by the reference asset value or formula.

Ranges or Range Accruals

“Range accrual notes” are notes where the principal, interest or any other amounts payable on the notes only accrue if the level, value or price of a reference asset is within a specified “range” or above or below a certain threshold value.

Upside Leverage Factor or Participation Rate

The principal, interest or any other amounts payable on the notes may be subject to an “upside leverage factor” or “participation rate”, which will have the effect of increasing your participation in the possible return, if any, on the notes. The upside leverage factor or participation rate may or may not be expressed as a percentage (i.e., expressed as 250% or 2.50).

We refer to an upside leverage factor or participation rate that is less than 100% or 1.00 as a “drag leverage factor”.

Downside Leverage Factor

The principal, interest or any other amounts payable on the notes may be subject to a “downside leverage factor”, which will have the effect of increasing your participation on the possible negative return, if any, on the notes. As a result, small negative changes in the reference asset will be magnified and have a greater effect than notes without a downside leverage factor. The downside leverage factor may or may not be expressed as a percentage (i.e., expressed as 125% or 1.25).

Barrier Percentage, Barrier Level or Protection Level and Protection Price

The principal, interest or any other amounts payable on the notes may be subject to a “barrier percentage”. Payment at maturity will be contingent upon whether the closing level of the reference asset declines and falls below a level equal to the product of the initial level and barrier percentage (the “barrier level”) at any time from and including the issue date to and including the final valuation date. The amount you receive may depend on whether the closing level ever fell below the barrier level during the term of the notes. We may also use the term “protection level” and “protection price”, which is equal to the product of the initial price multiplied by the protection level.

If the closing level never fell below the barrier level, barrier percentage or the protection price during the term of the notes, you will receive the full principal amount of notes.

Table of Contents

If the closing level ever fell below the barrier level, barrier percentage or protection price during the term of the notes, you may receive less than the principal amount of notes.

Buffer Percentage or Buffer Level

The payment at maturity may be fully principal protected against a decline in the reference asset up to a "buffer percentage" or "buffer level". In a bull note, if the performance of the reference asset as calculated on the final valuation date is greater than or equal to the buffer percentage, your principal is fully protected. Your principal is fully exposed to any decline in the reference asset below the buffer percentage. For every 1% decline of the reference asset beyond the buffer percentage, you will lose an amount equal to 1% of the principal amount of your notes multiplied by the downside leverage factor, if any.

Strike Level

The "strike level" is a level other than the initial level used to calculate the performance of the reference asset.

Initial Level or Initial Price

The "initial level" or "initial price" is the reference asset closing level or price on the initial valuation date or other date as specified in the applicable pricing supplement.

Final Level or Final Price

The "final level" or "final price" is the reference asset closing level or price on the final valuation date or the arithmetic average of the reference asset closing levels on each of the valuation dates or any other date or dates specified in the pricing supplement.

Closing Level

The closing level on any day during the term of the notes will be the closing level of the reference asset as determined by the calculation agent based upon the determinations with respect thereto made by the related sponsor.

Valuation Dates, Observation Dates or Averaging Dates

The final level, value or price may be calculated or based on more than one date, the "observation dates", "valuation dates" or "averaging dates". Each date will be the date stated in the applicable pricing supplement, unless the calculation agent determines that a market disruption event occurs or is continuing on any respective day. In that event, the valuation date, observation date or averaging date will be postponed as described under "Reference Assets—Securities or 'Linked Shares'—Market Disruption Events for Notes Relating to Notes with an Equity Security as the Reference Asset" with respect to reference assets comprised of an equity security, "Reference Assets—Indices—Market Disruption Events for Notes with the Reference Asset Comprised of an Index or Indices" with respect to reference assets comprised of an index, "Reference Assets—Commodities—Market Disruption Events Relating to Notes with a Commodity as the Reference Asset" with respect to reference assets comprised of a commodity and "Reference Assets—Currency Exchange Rates—Market Disruption Events Relating to Notes with the Reference Asset Comprised of a Currency Exchange Rate or Currency Exchange Rates" with respect to reference assets comprised of a currency exchange rate.

Where the reference asset is comprised of a floating interest rate, the calculation agent shall calculate the level, value or price for a disrupted valuation date, observation date or averaging date as described under "Reference Assets—Floating Interest Rate—Market Disruption Event Relating to Notes with a Floating Interest Rate as the Reference Asset".

For purposes of this prospectus supplement, valuation dates, observation dates and averaging dates shall herein be collectively referred to as "valuation dates".

Final Valuation Date, Final Observation Date or Final Averaging Date

The final level or price may be calculated or based on one or more dates, the "final valuation date", "final observation date" or the "final averaging date" which will be the last valuation date, observation date or averaging date,

Table of Contents

respectively. The final valuation, final observation date or final averaging date will be the date stated in the applicable pricing supplement, unless the calculation agent determines that a market disruption event occurs or is continuing on that day. In that event, the final valuation, final observation date or final averaging date will be postponed as described under "Reference Assets—Securities or 'Linked Shares'—Market Disruption Events for Notes Relating to Notes with an Equity Security as the Reference Asset" with respect to reference assets comprised of an equity security, "Reference Assets—Indices—Market Disruption Events for Notes with the Reference Asset Comprised of an Index or Indices" with respect to reference assets comprised of an index, "Reference Assets—Commodities—Market Disruption Events Relating to Notes with a Commodity as the Reference Asset" with respect to reference assets comprised of a commodity and "Reference Assets—Currency Exchange Rates—Market Disruption Events Relating to Notes with the Reference Asset Comprised of a Currency Exchange Rate or Currency Exchange Rates" with respect to reference assets comprised of a currency exchange rate.

Where the reference asset is comprised of a floating interest rate, the calculation agent shall calculate the final level, value or price for a disrupted valuation date, observation date or averaging date as described under "Reference Assets—Floating Interest Rate—Market Disruption Event Relating to Notes with a Floating Interest Rate as the Reference Asset".

For purposes of this prospectus supplement, the final valuation date, final observation date and final averaging date shall herein be collectively referred to as the " final valuation date".

Issuer Fee

The "issuer fee" equals an annual percentage multiplied by the number of years in the term of the notes, applied to the principal amount of the notes with daily accrual.

Basket Return

The "basket return" is the performance of a basket of reference assets, calculated as the percentage change in the final basket level as compared to the initial basket level or strike basket level.

Initial Basket Level

The "initial basket level" will be as specified in the pricing supplement.

Basket Level

The "basket level" is a function of the levels, values or prices of each component in the basket and will be determined by a formula set forth in the applicable pricing supplement.

Final Basket Level

The "final basket level" is the basket level on the basket final valuation date or the arithmetic average of the basket levels on each of the basket valuation dates or any other date or dates as specified in the pricing supplement.

Strike Basket Level

The "strike basket level" is a level other than the initial basket level used to calculate the basket return.

Basket Valuation Dates, Basket Observation Dates or Basket Averaging Dates

The final basket level may be calculated or based on more than one date, the "basket valuation dates", "basket observation dates" or "basket averaging dates". Each date will be the date stated in the applicable pricing supplement, unless the calculation agent determines that a market disruption event occurs or is continuing on any respective day. In that event, the "basket valuation dates", "basket observation dates" or "basket averaging dates" will be postponed as described under "Reference Assets—Baskets—Market Disruption Events for Notes with the Reference Asset Comprised of a Basket of Multiple Indices, Equity Securities, Foreign Currencies, Interest Rates, Commodities, any other Assets or any Combination Thereof".

For purposes of this prospectus supplement, basket valuation dates, basket observation dates and basket averaging dates shall herein be collectively referred to as "basket valuation dates".

Table of Contents

Basket Final Valuation Date, Basket Final Observation Date or Basket Final Averaging Date

The last basket valuation date, basket observation date or averaging date will be referred to as the "basket final valuation date", "basket final observation date" or "basket final averaging date", respectively, and will be the date stated in the applicable pricing supplement, unless the calculation agent determines that a market disruption event occurs or is continuing on that day. In that event, the "basket final valuation date", "basket final observation date" or "basket final averaging date" will be postponed as described under "Reference Assets—Baskets—Market Disruption Events for Notes with the Reference Asset Comprised of a Basket of Multiple Indices, Equity Securities, Foreign Currencies, Interest Rates, Commodities, any other Assets or any Combination Thereof".

For purposes of this prospectus supplement, the basket final valuation date, basket final observation date and basket final averaging date shall herein be collectively referred to as the "basket final valuation date".

Lesser Return

If specified in the applicable pricing supplement, the payment at maturity and/or interest payments will be linked to the performance of the reference asset with the lowest return in a group of two or more reference assets.

Lesser Performing Reference Asset

The "lesser performing reference asset" is the reference asset with the lesser return.

Exchangeable Notes

We may issue notes, referred to as "exchangeable notes", that are optionally or mandatorily exchangeable into cash or property. The exchangeable notes may or may not bear interest or be issued with original issue discount or at a premium. Exercise of the repayment option by the holder of a note will be irrevocable.

Optionally Exchangeable Notes. The holder of an exchangeable note may, during a period, or at a specific time or times, require us to repay the note for cash at a specified price.

Mandatorily Exchangeable Notes. The holder of a mandatorily exchangeable note must exchange the note for specified property at a specified rate of exchange, and therefore, depending upon the value of the specified property at maturity, the holder of a mandatorily exchangeable note may receive less than the principal amount of the note at maturity. If so indicated in the applicable pricing supplement, the specified rate at which a mandatorily exchangeable note may be exchanged may vary depending on the value of specified property. Mandatorily exchangeable notes may include notes where we have the right, but not the obligation, to require holders of notes to exchange their notes for the specified property.

Payment Upon Exchange. The applicable pricing supplement will specify whether upon exchange, at maturity or otherwise, the holder of an exchangeable note may receive, at the specified currency exchange rate, either the specified property or the cash value of the specified property. The specified property may be the securities of either U.S. or foreign entities or both. The exchangeable notes may or may not provide for protection against fluctuations in the currency exchange rate between the currency in which that note is denominated and the currency or currencies in which the market prices of the specified property are quoted. Exchangeable notes may have other terms and will be specified in the applicable pricing supplement.

Extendible Maturity Date

We may offer notes which will mature on an initial maturity date specified in the applicable pricing supplement, unless the holder extends the term of the note at its option for the period or periods specified in the applicable pricing supplement. The extension may be made on the initial "renewal date", which will be the interest payment date so specified in the applicable pricing supplement, prior to the initial maturity date of the note. Subsequent renewal dates will be specified in the applicable pricing supplement. Despite the foregoing, the term of the extendible note may not be extended beyond the final maturity date specified in the applicable pricing supplement.

If a holder does not elect to extend the term of any portion of the principal amount of an extendible note during the specified period prior to any renewal date, that portion will become due and payable on the existing maturity date.

Table of Contents

An election to renew the term of an extendible note may be made by delivering a notice to that effect to the trustee or any duly appointed paying agent at the corporate trust office of the trustee or agency of the trustee in New York City. The notice must be delivered not less than three nor more than 15 days prior to the renewal date (unless another period is specified in the applicable pricing supplement as the notice period). The election will be irrevocable and will be binding upon each subsequent holder of the extendible note.

An election to renew the term of an extendible note may be exercised for less than the entire principal amount of the extendible note only if so specified in the applicable pricing supplement and only in the amount, or any integral multiple in excess of that amount, that is specified in the applicable pricing supplement.

If the holder does not elect to renew the term, a new note will be issued in exchange for the extendible note on the extension date. If the extendible note is a certificate issued in definitive form, it must be presented to the trustee as soon as practicable following receipt of the new note. The new note will be in a principal amount equal to the principal amount of the exchanged extendible note for which no election to renew the term was exercised, with terms identical to those specified on the extendible note. However, the note will have a fixed stated maturity on the then-existing maturity date.

If an election to renew is made for less than the full principal amount of a holder's extendible note, the trustee, or any duly appointed paying agent, will issue in exchange for the note in the name of the holder, a replacement extendible note. The replacement extendible note will be in a principal amount equal to the principal amount elected to be renewed of the exchanged extendible note, with terms otherwise identical to the exchanged extendible note.

If a note is represented by a global security, DTC's nominee will be the holder of the note and, therefore, will be the only entity that can exercise a right to extend a note. In order to ensure that DTC's nominee will timely exercise an extension right relating to a particular note, the beneficial owner of the note must instruct the broker or other direct or indirect participant through which it holds an interest in the note to notify DTC of its desire to exercise an extension right. Different firms have different cut-off times for accepting instructions from their customers. Accordingly, each beneficial owner should consult the broker or other direct or indirect participant through which it holds an interest in a note in order to ascertain the cut-off time by which that type of instruction must be given for timely notice to be delivered to DTC.

Autocallable Notes

The applicable pricing supplement will indicate the terms of our option, if any, to call or redeem the notes, in whole or in part. We will notify each holder, or in the case of global notes, the depositary, as holder of the global notes within the notice period for the call or redemption specified in the applicable pricing supplement. See "Terms of the Notes—Redemption and Repurchase".

Automatic Call

If specified in the applicable pricing supplement, the notes will be automatically "callable" or "redeemable". If the level of the reference asset on any review date is equal to or greater than the call level, the autocallable notes will automatically be redeemed for a cash payment as detailed in the applicable pricing supplement.

Call Level

The minimum level of the reference asset which triggers an automatic call on a review date and payment of the applicable call premium.

Call Premium, Call Price and Redemption Price

The "call premium", call price or redemption price is the additional amount which we will pay you if the notes are called or redeemed. The call premium can be expressed as a percentage and will be specified in the applicable pricing supplement.

The "call price or redemption price" is the aggregate amount, including the call premium, if any, which we will pay you if the notes are called or redeemed. The call price or redemption price can be expressed as a percentage and will be specified in the applicable pricing supplement.

Table of Contents

If the notes are automatically called, payment will be made on the fifth business day after the applicable review date, subject to postponement in the event of certain market disruption events. If the notes are automatically called on the last review date, we will redeem each note and pay you on the maturity date.

The applicable pricing supplement will indicate the call premium, if any, the call price, the review dates, the optional call dates or the optional redemption dates and the respective business day convention(s).

Review Dates

If the notes are automatically callable, the review dates will be detailed in the applicable pricing supplement and are subject to postponement in the event of certain market disruption events.

If a review date (including the final review date) is not a business day or if there is a market disruption event on that day, the applicable review date will be the first following business day on which the calculation agent determines that a market disruption event does not occur and is not continuing. In no event, however, will the review date be postponed by more than five business days. If the closing level or price of the reference asset is not available on the last possible review date either because of a market disruption event or for any other reason, the calculation agent will make an estimate of the closing level or price for each reference asset for that review date that would have prevailed in the absence of the market disruption event.

If, due to a market disruption event or otherwise, a review date (other than the final review date) is postponed so that it falls less than five business days prior to the scheduled optional call dates or optional redemption dates, the date on which the call price for that review date will be paid, if any, will be the fifth business day following the review date as postponed, unless otherwise specified in the applicable pricing supplement.

Optional Call Dates or Optional Redemption Dates

We, at our election, may call or redeem the notes in whole or in part on any optional call date or any optional redemption date. The applicable pricing supplement will indicate the optional call dates or the optional redemption dates and the respective business day convention.

Reverse Convertible Notes

No Principal Protection

If the notes are “reverse convertible notes”, the principal amount of your investment is not protected and you may receive less, and possibly significantly less, than the amount you invested. The amount of the principal payment at maturity will depend on two variables: (i) the price or level of the reference asset; and (ii) the relationship between the final price and the initial price of the reference asset.

You will receive 100% of your principal at maturity if, either of the following is true: (i) the final price or level is equal to or greater than the initial price or level of the reference asset; or (ii) the price or level of the reference asset on any day never falls below the protection price during the term of the notes.

However, the notes will not be principal protected if both of the following are true: (i) the final price or level is less than the initial price or level of the reference asset; and (ii) the price of the reference asset on any day falls below the protection price during the term of the notes. If both of those conditions are true, the principal amount of your investment will not be protected and you will receive less, and possibly significantly less, than the amount you invested.

Payment at Maturity

Your payment at maturity for each note you hold will depend on the performance of the reference asset between the initial valuation date and the final valuation date, inclusive. You will receive the full principal amount of your notes at maturity unless: (a) the final price of the reference asset is lower than the initial price of the reference asset and (b) between the initial valuation date and the final valuation date, inclusive, the price of the reference asset on any day is below the protection price. If the conditions described in (a) and (b) are both true, at maturity you will receive at our election, instead of the principal amount of your notes, either (i) the physical delivery amount of the reference asset (fractional shares to be paid in cash in an amount equal to the fractional shares multiplied by the final price), or (ii) a cash amount equal to

Table of Contents

the principal amount you invested reduced by the percentage decrease in the reference asset; provided that the election of clause (i) is only available if the reference asset is a security, or "linked shares". See "Reference Assets—Securities or 'Linked Shares'" below.

In the event that the maturity date is postponed as described under "Terms of the Notes—Maturity Date" above, the related payment of principal will be made on the postponed maturity date.

You may lose some or all of your principal if you invest in the reverse convertible notes.

Physical Delivery Amount

If the payment at maturity is in linked shares, the number of shares received is referred to as the "physical delivery amount" (fractional shares to be paid in cash). The physical delivery amount will be calculated by the calculation agent by dividing the principal amount of your notes by the initial price of the linked shares. The physical delivery amount, the initial price of the linked shares and other amounts may change due to stock splits or other corporate actions. See "Reference Assets—Securities or 'Linked Shares'—Share Adjustments Relating to Notes with an Equity Security as the Reference Asset—Antidilution Adjustments" below.

REFERENCE ASSETS

Fixed Interest Rate

If the applicable notes have a fixed interest rate, the notes for that particular offering will bear interest from and including the original issue date or any other date specified in the applicable pricing supplement at the annual rate stated in the applicable pricing supplement until the principal is paid or made available for payment.

Floating Interest Rate

If the applicable notes have a floating interest rate, the notes for that particular offering will bear interest at a floating rate determined by reference to an interest rate or interest rate formula, which we refer to as the "reference asset". The reference asset may be one or more of the following:

- the CD rate,
- the CMS rate,
- the CMT rate,
- the commercial paper rate,
- the Consumer Price Index,
- the eleventh district cost of funds rate,
- EURIBOR,
- the federal funds (effective) rate,
- the federal funds (open) rate,
- LIBOR,
- the prime rate,
- the Treasury rate,
- a combination of any, or
- any other rate or interest rate formula specified in the applicable pricing supplement and in the floating rate note.

CD Rate

The "CD rate" means, for any interest determination date, the rate on that date for negotiable U.S. dollar certificates of deposit having the index maturity specified in the applicable pricing supplement as published by the Board of Governors of the Federal Reserve System in "Statistical Release H.15(519), Selected Interest Rates", or any successor publication of the Board of Governors of the Federal Reserve System ("H.15(519)") under the heading "CDs (Secondary Market)".

The following procedures will be followed if the CD rate cannot be determined as described above:

- If the above rate is not published in H.15(519) by 3:00 p.m., New York City time, on the interest determination date, the CD rate will be the rate on that interest determination date set forth in the daily update of H.15(519), available through the world wide website of the Board of Governors of the Federal Reserve System, or any successor site or publication, which is commonly referred to as the "H.15 Daily Update", for the interest determination date for certificates of deposit having the index maturity specified in the applicable pricing supplement , under the caption "CDs (Secondary Market)".

Table of Contents

- If the above rate is not yet published in either H.15(519) or the H.15 Daily Update by 3:00 p.m., New York City time, on the interest determination date, the calculation agent will determine the CD rate to be the arithmetic mean of the secondary market offered rates as of 10:00 a.m., New York City time, on that interest determination date of three leading nonbank dealers in negotiable U.S. dollar certificates of deposit in The City of New York, which may include the agent and its affiliates, selected by the calculation agent, after consultation with us, for negotiable U.S. dollar certificates of deposit of major U.S. money center banks of the highest credit standing in the market for negotiable certificates of deposit with a remaining maturity closest to the index maturity specified in the applicable pricing supplement in an amount that is representative for a single transaction in that market at that time.
- If the dealers selected by the calculation agent are not quoting as set forth above, the CD rate for that interest determination date will remain the CD rate for the immediately preceding interest reset period, or, if there was no interest reset period, the rate of interest payable will be the initial interest rate.

CMS Rate

The "CMS rate" means, on any day during an interest payment period, the rate for U.S. dollar swaps with a maturity for a specified number of years, expressed as a percentage in the applicable pricing supplement, which appears on Reuters screen "ISDAFIX1" page as of 11:00 a.m., New York City time, on the related interest determination date.

The following procedures will be used if the CMS rate cannot be determined as described above:

- If the above rate is no longer displayed on the relevant page, or if not displayed by 11:00 a.m., New York City time, on the interest determination date, then the CMS rate will be the rate for U.S. dollar swaps with a maturity of the notes designated in the applicable pricing supplement, expressed as a percentage, which appears on the Reuters screen "ISDAFIX1" page as of 11:00 a.m., New York City time, on the interest determination date.
- If that information is no longer displayed by 11:00 a.m., New York City time, on the interest determination date, then the CMS rate will be a percentage determined on the basis of the mid-market, semi-annual swap rate quotations provided by five leading swap dealers in the New York City interbank market at approximately 11:00 a.m., New York City time, on the interest determination date. For this purpose, the semi-annual swap rate means the mean of the bid and offered rates for the semi-annual fixed leg, calculated on a 30/360 day count basis, of a fixed-for-floating U.S. dollar interest rate swap transaction with a term equal to the maturity of the notes designated in the applicable pricing supplement commencing on that interest determination date with an acknowledged dealer of good credit in the swap market, where the floating leg, calculated on an Actual/ 360 day count basis, is equivalent to "LIBOR Moneyline Telerate" with a maturity of three months. The calculation agent will select the five swap dealers after consultation with us and will request the principal New York City office of each of those dealers to provide a quotation of its rate. If at least three quotations are provided, the CMS rate for that interest determination date will be the arithmetic mean of the quotations, eliminating the highest and lowest quotations or, in the event of equality, one of the highest and one of the lowest quotations.
- If fewer than three leading swap dealers selected by the calculation agent are quoting as described above, the CMS rate will remain the CMS rate in effect on that interest determination date or, if that interest determination date is the first interest determination date, the initial interest rate.

CMT Rate

The "CMT rate" means, for any interest determination date, the rate as set forth in H.15(519) as defined below, under the caption "Treasury constant maturities", for:

- the rate on that interest determination date, if the Designated CMT Telerate page, as defined below, is 7051; and

Table of Contents

- the week or the month, as applicable, ended immediately preceding the week in which the related interest determination date occurs, if the Designated CMT Telerate page is 7052.

CMT rates are yields interpolated by the United State Department of the Treasury from its daily yield curve. That yield curve, which relates to the yield on a U.S. Treasury security to its time to maturity, is based on the closing market bid yields on actively traded U.S. Treasury securities in the over-the-counter market. These market yields are calculated from composites of quotations obtained by the Federal Reserve Bank of New York. The yield values are read from the yield curve at fixed maturities. This method provides yields for a 2-year maturity, for example, even if no outstanding U.S. Treasury security has exactly 2 years remaining to maturity.

“USD-CMT-T7051” means that the rate for the interest determination date will be a percentage equal to the yield for U.S. Treasury securities at “constant maturity” for a period of “designated maturity”, as specified in the applicable pricing supplement, and for that interest determination date as set forth in H.15(519) under the caption “Treasury constant maturities”, as that yield is displayed on the Telerate page 7051 for the interest determination date on the day that is two U.S. government securities business days prior to that interest determination date. If that rate does not appear on the Telerate page 7051, the rate for that interest determination date will be a percentage equal to the yield for U.S. Treasury securities at “constant maturity” for a period of the designated maturity and for that interest determination date as set forth in H.15(519) under the caption “Treasury constant maturities”. If that rate does not appear in H.15(519), the rate for that interest determination date will be the rate for a period of the designated maturity as may then be published by either the Federal Reserve System Board of Governors or the U.S. Department of the Treasury that the calculation agent determines to be comparable to the rate which would otherwise have been published in H.15-519.

“1-year CMT rate” means the USD-CMT-T7051 rate with a designated maturity of 1 year.

“2-year CMT rate” means the USD-CMT-T7051 rate with a designated maturity of 2 years.

“3-year CMT rate” means the USD-CMT-T7051 rate with a designated maturity of 3 years.

“5-year CMT rate” means the USD-CMT-T7051 rate with a designated maturity of 5 years.

“7-year CMT rate” means the USD-CMT-T7051 rate with a designated maturity of 7 years.

“10-year CMT rate” means the USD-CMT-T7051 rate with a designated maturity of 10 years.

“20-year CMT rate” means the USD-CMT-T7051 rate with a designated maturity of 20 years.

“30-year CMT rate” means the USD-CMT-T7051 rate with a designated maturity of 30 years.

The following procedures will be followed if the CMT rate cannot be determined as described above:

- If the CMT rate is not displayed on the relevant page by 3:30 p.m., New York City time on the related interest determination date, then the CMT rate will be a percentage equal to the yield for U.S. Treasury securities at “constant maturity” for the Designated CMT Maturity Index on the related interest determination date as set forth in H.15(519) under the caption “Treasury constant maturities”.
- If the applicable rate described above does not appear in H.15(519) then the CMT rate on the related interest determination date will be the rate for the Designated CMT Maturity Index as may then be published by either the Board of Governors of the Federal Reserve System or the U.S. Department of the Treasury that the calculation agent determines to be comparable to the rate formerly displayed on the Designated CMT Telerate page and published in the relevant H.15(519).
- If on the related interest determination date, neither the Board of Governors of the

Table of Contents

Federal Reserve System nor the U.S. Department of the Treasury publishes a yield on U.S. Treasury securities at a "constant maturity" for the Designated CMT Maturity Index, the CMT rate on the related interest determination date will be calculated by the calculation agent and will be a yield-to-maturity based on the arithmetic mean of the secondary market bid prices at approximately 3:30 p.m., New York City time, on the related interest determination date, of three leading primary U.S. government securities dealers in New York City. The calculation agent will select five such securities dealers, and will eliminate the highest quotation (or, in the event of equality, one of the highest) and the lowest quotation (or, in the event of equality, one of the lowest), for U.S. Treasury securities with an original maturity equal to the Designated CMT Maturity Index, a remaining term to maturity of no more than one year shorter than that Designated CMT Maturity Index and in a principal amount equal to the Representative Amount. If two bid prices with an original maturity as described above have remaining terms to maturity equally close to the Designated CMT Maturity Index, the quotes for the U.S. Treasury security with the shorter remaining term to maturity will be used. The "Representative Amount" means an amount equal to the outstanding principal amount of the notes.

- If fewer than five but more than two such prices are provided as requested, the CMT rate for the related interest determination date will be based on the arithmetic mean of the bid prices obtained and neither the highest nor the lowest of those quotations will be eliminated.
- If the calculation agent cannot obtain three U.S. Treasury securities quotations of the kind requested in the prior two paragraphs, the calculation agent will determine the CMT rate to be the yield to maturity based on the arithmetic mean of the secondary market bid prices for U.S. Treasury securities, at approximately 3:30 p.m., New York City time, on the related interest determination date of three leading primary U.S. government securities dealers in New York City. In selecting these bid prices, the calculation agent will request quotations from at least five of those securities dealers and will disregard the highest quotation (or if there is equality, one of the highest) and the lowest quotation (or if there is equality, one of the lowest) for U.S. Treasury securities with an original maturity greater than the Designated CMT Maturity Index, a remaining term to maturity closest to the Designated CMT Maturity Index and in a Representative Amount. If two U.S. Treasury securities with an original maturity longer than the Designated CMT Maturity Index have remaining terms to maturity that are equally close to the Designated CMT Maturity Index, the calculation agent will obtain quotations for the U.S. Treasury security with the shorter remaining term to maturity.
- If fewer than five but more than two of the leading primary U.S. government securities dealers provide quotes as described in the prior paragraph, then the CMT rate will be based on the arithmetic mean of the bid prices obtained, and neither the highest nor the lowest of those quotations will be eliminated.
- If fewer than three leading primary U.S. government securities reference dealers selected by the calculation agent provide quotes as described above, the CMT rate will be determined by the calculation agent.

"Designated CMT Telerate page" means the display on Moneyline Telerate, or any successor service, on the page designated in the applicable pricing supplement or any other page as may replace that page on that service for the purpose of displaying Treasury Constant Maturities as reported in H.15(519). If no page is specified in the applicable pricing supplement the Designated CMT Telerate page will be 7052, for the most recent week.

"H.15(519)" means the weekly statistical release designated as such, or any successor publication, published by the Board of Governors of the Federal Reserve System, available through the world-wide-web site of the Board of Governors of the Federal Reserve System at http://www.federalreserve. gov/releases/H15/ or any successor site or publication. We make no representation or warranty as to the accuracy or completeness of the information displayed on that website, and that information is not incorporated by reference herein and should not be considered a part of this prospectus supplement.

Table of Contents

"Designated CMT Maturity Index" means the original period to maturity of the U.S. Treasury securities, which is either 1, 2, 3, 5, 7, 10, 20 or 30 years, specified in the applicable pricing supplement for which the CMT rate will be calculated. If no maturity is specified in the applicable pricing supplement the Designated CMT Maturity Index will be two years.

Commercial Paper Rate

The "commercial paper rate" means, for any interest determination date, the money market yield, calculated as described below, of the rate on that date for commercial paper having the index maturity specified in the applicable pricing supplement, as that rate is published in H.15(519), under the heading "Commercial Paper—Nonfinancial".

The following procedures will be followed if the commercial paper rate cannot be determined as described above:

- If the above rate is not published by 3:00 p.m., New York City time, on the interest determination date, then the commercial paper rate will be the money market yield of the rate on that interest determination date for commercial paper of the index maturity specified in the applicable pricing supplement as published in the H.15 Daily Update, or other recognized electronic source used for the purpose of displaying the applicable rate, under the heading "Commercial Paper—Nonfinancial".
- If by 3:00 p.m., New York City time, on that interest determination date the rate is not yet published in either H.15(519) or the H.15 Daily Update, then the calculation agent will determine the commercial paper rate to be the money market yield of the arithmetic mean of the offered rates as of 11:00 a.m., New York City time, on that interest determination date of three leading dealers of U.S. dollar commercial paper in The City of New York, which may include the agent and its affiliates, selected by the calculation agent, after consultation with us, for commercial paper of the index maturity specified in the applicable pricing supplement, placed for an industrial issuer whose bond rating is "AA", or the equivalent, from a nationally recognized statistical rating agency.
- If the dealers selected by the calculation agent are not quoting as set forth above, the commercial paper rate for that interest determination date will remain the commercial paper rate for the immediately preceding interest reset period, or, if there was no interest reset period, the rate of interest payable will be the initial interest rate.

The "money market yield" will be a yield calculated in accordance with the following formula:

$$\text{money market yield} = \frac{(D \times 360)}{360 - (D \times M)} \times 100$$

where, "D" refers to the applicable per year rate for commercial paper quoted on a bank discount basis and expressed as a decimal and "M" refers to the actual number of days in the interest payment period for which interest is being calculated.

Consumer Price Index

The "Consumer Price Index" or "CPI" means, for any interest determination date, the non-seasonally adjusted U.S. City Average All Items Consumer Price Index for All Urban Consumers, published monthly by the Bureau of Labor Statistics of the U.S. Department of Labor (the "Bureau of Labor Statistics") and reported on Bloomberg ticker "CPURNSA" or any successor service. The Bureau of Labor Statistics makes the majority of its consumer price index data and press releases publicly available immediately at the time of release. This material may be accessed electronically by means of the Bureau of Labor Statistics' home page on the Internet at http://www.bls.gov. The Consumer Price Index for a particular month is published during the following month. The Consumer Price Index is a measure of the average change in consumer prices over time for a fixed market basket of goods and services, including food, clothing, shelter, fuels, transportation, charges for doctors and dentists services, and drugs. User fees (such as water and sewer service) and sales and excise taxes paid by the consumer are included in determining consumer prices. Income taxes and investment items such as stocks, bonds and life insurance are not

Table of Contents

included. The Consumer Price Index includes expenditures by urban wage earners and clerical workers, professional, managerial and technical workers, the self-employed, short-term workers, the unemployed, retirees and others not in the labor force. In calculating the Consumer Price Index, price changes for the various items are averaged together with weights that represent their importance in the spending of urban households in the United States. The contents of the market basket of goods and services and the weights assigned to the various items are updated periodically by the Bureau of Labor Statistics to take into account changes in consumer expenditure patterns.

The Consumer Price Index is expressed in relative terms in relation to a time base reference period for which the level is set at 100.0. The time base reference period is the 1982–1984 average. Because the Consumer Price Index for the period from 1982–1984 is 100, an increase in the price of the fixed market basket of goods and services of 16.5% from that period would be shown as 116.5%. If the Bureau of Labor Statistics rebases the Consumer Price Index when the notes are outstanding, the calculation agent will continue to calculate inflation using 1982–1984 as the base reference period for so long as the current Consumer Price Index continues to be published. Any conversion by the Bureau of Labor Statistics to a new reference base will not affect the measurement of the percent changes in a given index series from one time period to another, except for rounding differences. Rebasing might affect the published "headline" number often quoted in the financial press, but the inflation calculation for the notes should not be adversely affected by any rebasing because the Consumer Price Index based on 1982–1984 will be calculated using the percentage changes of the rebased Consumer Price Index.

The Bureau of Labor Statistics has made technical and methodological changes to the Consumer Price Index, and is likely to continue to do so. Examples of recent methodological changes include:

- the use of regression models to adjust for improvements in the quality of various goods (televisions, personal computers, etc.);
- the introduction of geometric averages to account for consumer substitution within the consumer price index categories; and
- changing the housing/shelter formula to increase rental equivalence estimation.

Similar changes in the future could affect the level of the Consumer Price Index and alter the interest payable on the notes.

"CPI Performance" means the annual percentage change for a month, as specified in the applicable pricing supplement, prior to the month of the relevant interest payment date (the "reference month").

For example, if the performance of the Consumer Price Index is the annual percentage change in the Consumer Price Index for the third calendar month prior to the reference month, then the interest rate payable on June 30, 2006 will reflect the percentage change in the Consumer Price Index from March 2005 to March 2006 plus the applicable spread, if any. The performance of the Consumer Price Index will be calculated as follows:

$$\text{Interest Rate} = \left(\frac{CPI_F - CPI_I}{CPI_I} \right)$$

where,

CPI_F = CPI for the applicable reference month, as published on Bloomberg CPURNSA;

CPI_I = CPI for the twelfth month, or otherwise as specified in the applicable pricing supplement, prior to the applicable reference month, as published on Bloomberg CPURNSA.

Using the example above, if CPI Performance for the second calendar month prior to the reference month was used, then the interest rate payable on June 30, 2006 will reflect the percentage change in the Consumer Price Index from April 2005 to April 2006 plus the applicable spread, if any.

If the performance of the Consumer Price Index for a particular reference month is equal to or less than the spread, you will not receive an interest payment on the corresponding interest payment date. The interest payment on any interest payment date will not be less than 0.00% per annum, unless specified in the applicable pricing supplement.

Table of Contents

The following procedures will be followed if the Consumer Price Index cannot be determined as described above:

- If the Consumer Price Index is not reported on Bloomberg CPURNSA for a particular month by 3:00 PM on the interest determination date, but has otherwise been published by the Bureau of Labor Statistics, the calculation agent will determine the Consumer Price Index as published by the Bureau of Labor Statistics for that month using any other source as the calculation agent deems appropriate.
- If the Consumer Price Index is rebased to a different year or period, the base reference period will continue to be the 1982-1984 reference period as long as the 1982-1984 Consumer Price Index continues to be published.
- If the Consumer Price Index for the reference month is subsequently revised by the Bureau of Labor Statistics, the calculation agent will continue to use the Consumer Price Index initially published by the Bureau of Labor Statistics on the interest reset date.
- If, while the notes are outstanding, the Consumer Price Index is discontinued or substantially altered, as determined by the calculation agent, the applicable substitute index for the notes will be that chosen by the Secretary of the Treasury for the Department of Treasury's Inflation-Linked Treasuries as described at 62 Federal Register 846-874 (January 6, 1997). If none of those securities are outstanding, the calculation agent will determine a substitute index for the notes in accordance with general market practice at the time.

Eleventh District Cost of Funds

The "eleventh district cost of funds rate" or "COFI" means, for any interest determination date, the rate on the applicable interest determination date equal to the monthly weighted average cost of funds for the calendar month preceding the interest determination date as displayed under the caption "Eleventh District" on Telerate page 7058. "Telerate page 7058" means the display page designated as page 7058 on Moneyline Telerate, or any successor service or page, for the purpose of displaying the monthly weighted average cost of funds paid by member institutions of the Eleventh Federal Home Loan Bank District.

The following procedures will be followed if the eleventh district cost of funds rate cannot be determined as described above:

- If the above rate is not displayed by 3:00 p.m., New York City time, on the interest determination date for the applicable interest determination date, the eleventh district cost of funds rate will be the eleventh district cost of funds rate index on the applicable interest determination date.
- If the Federal Home Loan Bank of San Francisco fails to announce the rate for the calendar month next preceding the applicable interest determination date, then the eleventh district cost of funds rate for the new interest reset period will be the same as for the immediately preceding period. If there was no such interest reset period, the eleventh district cost of funds rate index will be the initial interest rate.

The "eleventh district cost of funds rate index" means the monthly weighted average cost of funds paid by member institutions of the Eleventh Federal Home Loan Bank District that the Federal Home Loan Bank of San Francisco most recently announced as the cost of funds for the calendar month preceding the date of the announcement.

EURIBOR

"EURIBOR" means, for any interest determination date, the rate for deposits in euros as sponsored, calculated and published jointly by the European Banking Federation and ACI—The Financial Market Association, or any company established by the joint sponsors for purposes of compiling and publishing those rates, for the index maturity specified in the applicable pricing supplement as that rate appears on the display on Moneyline Telerate, or any successor service, on page 248 or any other page as may replace page 248 on that service, which is commonly referred to as "Telerate page 248", as of 11:00 a.m., Brussels time.

Table of Contents

The following procedures will be followed if the rate cannot be determined as described above:

- If the above rate does not appear, the calculation agent will request the principal Euro-zone office of each of four major banks in the Euro-zone interbank market, as selected by the calculation agent, after consultation with us, to provide the calculation agent with its offered rate for deposits in euros, at approximately 11:00 a.m., Brussels time, on the interest determination date, to prime banks in the Euro-zone interbank market for the index maturity specified in the applicable pricing supplement commencing on the applicable interest reset date, and in a principal amount not less than the equivalent of US$1 million in euro that is representative of a single transaction in euro, in that market at that time. If at least two quotations are provided, EURIBOR will be the arithmetic mean of those quotations.
- If fewer than two quotations are provided, EURIBOR will be the arithmetic mean of the rates quoted by four major banks in the Euro-zone interbank market, as selected by the calculation agent, after consultation with us, at approximately 11:00 a.m., Brussels time, on the applicable interest reset date for loans in euro to leading European banks for a period of time equivalent to the index maturity specified in the applicable pricing supplement commencing on that interest reset date in a principal amount not less than the equivalent of US$1 million in euro that is representative of a single transaction in euro, in that market at that time.
- If the banks so selected by the calculation agent are not quoting as set forth above, EURIBOR for that interest determination date will remain EURIBOR for the immediately preceding interest reset period, or, if there was no interest reset period, the rate of interest payable will be the initial interest rate.

“Euro-zone” means the region comprising member states of the European Union that have adopted the single currency in accordance with the relevant treaty of the European Union, as amended.

Federal Funds (Effective) Rate

The “federal funds (effective) rate” means, for any interest determination date, the rate on that date for federal funds as published in H.15(519) under the heading “Federal Funds (Effective)” as displayed on Moneyline Telerate, or any successor service, on page 120 or any other page as may replace the applicable page on that service, which is commonly referred to as “Telerate page 120”.

The following procedures will be followed if the federal funds (effective) rate cannot be determined as described above:

- If the above rate is not published by 3:00 p.m., New York City time, on the interest determination date, the federal funds (effective) rate will be the rate on that interest determination date as published in the H.15 Daily Update, or other recognized electronic source used for the purpose of displaying the applicable rate, under the heading “Federal Funds/Effective Rate”.
- If the above rate is not yet published in either H.15(519) or the H.15 Daily Update by 3:00 p.m., New York City time, on the interest determination date, the calculation agent will determine the federal funds (effective) rate to be the arithmetic mean of the rates for the last transaction in overnight U.S. dollar federal funds by each of three leading brokers of U.S. dollar federal funds transactions in The City of New York, which may include the agent and its affiliates, selected by the calculation agent, after consultation with us, prior to 9:00 a.m., New York City time, on that interest determination date.
- If the brokers selected by the calculation agent are not quoting as set forth above, the federal funds rate for that interest determination date will remain the federal funds (effective) rate for the immediately preceding interest reset period, or, if there was no interest reset period, the rate of interest payable will be the initial interest rate.

Table of Contents

Federal Funds (Open) Rate

The "federal funds (open) rate" means, for any interest determination date, the rate on that date for federal funds as published in H.15(519) under the heading "Federal Funds" and opposite the caption "Open", as displayed on Moneyline Telerate, or any successor service, on page 5 or any other page as may replace the applicable page on that service, which is commonly referred to as "Telerate page 5".

The following procedures will be followed if the federal funds (open) rate cannot be determined as described above:

- If the above rate is not published by 3:00 p.m., New York City time, on the interest determination date, the federal funds (open) rate will be the rate on that interest determination date as published on Bloomberg, or other recognized electronic source used for the purpose of displaying the applicable rate, on FEDSPREB Index.
- If the above rate is not yet published on either Telerate page 5 or FEDSPREB Index on Bloomberg by 3:00 p.m., New York City time, on the interest determination date, the calculation agent will determine the federal funds (open) rate to be the arithmetic mean of the rates for the last transaction in overnight U.S. dollar federal funds by each of three leading brokers of U.S. dollar federal funds transactions in The City of New York, which may include the agent and its affiliates, selected by the calculation agent, after consultation with us, prior to 9:00 a.m., New York City time, on that interest determination date.
- If the brokers selected by the calculation agent are not quoting as set forth above, the federal funds rate for that interest determination date will remain the federal funds (open) rate for the immediately preceding interest reset period, or, if there was no interest reset period, the rate of interest payable will be the initial interest rate.

LIBOR

Notes having a coupon based on "LIBOR" or the London Interbank Offered Rate will bear interest at the interest rates specified in the applicable pricing supplement. The calculation agent will determine "LIBOR" for each interest determination date as follows:

- As of the interest determination date, LIBOR will be either:
  - if "LIBOR Reuters" is specified in the applicable pricing supplement, the arithmetic mean of the offered rates for deposits in the index currency having the index maturity designated in the applicable pricing supplement, commencing on the second London banking day immediately following that interest determination date, that appear on the Designated LIBOR page, as defined below, as of 11:00 a.m., London time, on that interest determination date, if at least two offered rates appear on the Designated LIBOR page; except that if the specified Designated LIBOR page, by its terms provides only for a single rate, that single rate will be used; or
  - if "LIBOR Telerate" is specified in the applicable pricing supplement, the rate for deposits in the index currency having the index maturity designated in the applicable pricing supplement, commencing on the second London banking day immediately following that interest determination date or, if pounds sterling is the index currency, commencing on that interest determination date, that appears on the Designated LIBOR page at approximately 11:00 a.m., London time, on that interest determination date.
- If (i) fewer than two offered rates appear and "LIBOR Reuters" is specified in the applicable pricing supplement, or (ii) no rate appears and the applicable pricing supplement specifies either (a) "LIBOR Telerate" or (b) "LIBOR Reuters" and the Designated LIBOR page by its terms provides only for a single rate, then the calculation agent will request the principal London offices of each of four major reference banks in the London interbank market, as selected by the calculation agent after consultation with us, to provide the calculation agent with its offered quotation for deposits in the index currency for the period of the index maturity specified in the

Table of Contents

applicable pricing supplement commencing on the second London banking day immediately following the interest determination date or, if pounds sterling is the index currency, commencing on that interest determination date, to prime banks in the London interbank market at approximately 11:00 a.m., London time, on that interest determination date and in a principal amount that is representative of a single transaction in that index currency in that market at that time.

- If at least two quotations are provided, LIBOR determined on that interest determination date will be the arithmetic mean of those quotations. If fewer than two quotations are provided, LIBOR will be determined for the applicable interest reset date as the arithmetic mean of the rates quoted at approximately 11:00 a.m., London time, or some other time specified in the applicable pricing supplement, in the applicable principal financial center for the country of the index currency on that interest reset date, by three major banks in that principal financial center selected by the calculation agent, after consultation with us, for loans in the index currency to leading European banks, having the index maturity specified in the applicable pricing supplement and in a principal amount that is representative of a single transaction in that index currency in that market at that time.
- If the banks so selected by the calculation agent are not quoting as set forth above, LIBOR for that interest determination date will remain LIBOR for the immediately preceding interest reset period, or, if there was no interest reset period, the rate of interest payable will be the initial interest rate.

The “index currency” means the currency specified in the applicable pricing supplement as the currency for which LIBOR will be calculated, or, if the euro is substituted for that currency, the index currency will be the euro. If that currency is not specified in the applicable pricing supplement, the index currency will be U.S. dollars.

“Designated LIBOR page” means either (i) if “LIBOR Reuters” is designated in the applicable pricing supplement, the display on the Reuters Monitor Money Rates Service for the purpose of displaying the London interbank rates of major banks for the applicable index currency or its designated successor, or (ii) if “LIBOR Telerate” is designated in the applicable pricing supplement, the display on Moneyline Telerate, or any successor service, on the page specified in the applicable pricing supplement, or any other page as may replace that page on that service, for the purpose of displaying the London interbank rates of major banks for the applicable index currency.

“USD-LIBOR-BBA” means that the rate for an interest determination date will be the rate for deposits in U.S. dollars for a period of the “designated maturity”, specified in the applicable pricing supplement, which appears on the Telerate page 3750 as of 11:00 a.m., London time, on the day that is two London banking days preceding that interest determination date. If that rate does not appear on the Telerate page 3750, the rate for that interest determination date will be determined as if the parties had specified “USD-LIBOR-Reference Banks” as the applicable floating rate option.

“USD-LIBOR-Reference Banks” means that the rate for a interest determination date will be determined on the basis of the rates at which deposits in U.S. dollars are offered by four major banks in the London interbank market (“reference banks”) at approximately 11:00 a.m., London time, on the day that is two London banking days preceding that interest determination date to prime banks in the London interbank market for a designated period commencing on that interest determination date and in a designated amount. The calculation agent will request the principal London office of each of the reference banks to provide a quotation of its rate. If at least two of those quotations are provided, the rate for that interest determination date will be the arithmetic mean of the quotations. If fewer than two quotations are provided as requested, the rate for that interest determination date will be the arithmetic mean of the rates quoted by major banks in New York City, selected by the calculation agent, at approximately 11:00 a.m., New York City time, on that interest reset date for loans in U.S. dollars to leading European banks for a designated period commencing on that interest determination date and in a designated amount.

Table of Contents

"One-month LIBOR" means the USD-LIBOR-BBA rate with a designated maturity of one month commencing on the interest reset date.

"Three-month LIBOR" means the USD-LIBOR-BBA rate with a designated maturity of three months commencing on the interest reset date.

"Six-month LIBOR" means the USD-LIBOR-BBA rate with a designated maturity of six months commencing on the interest reset date.

"Nine-month LIBOR" means the USD-LIBOR-BBA rate with a designated maturity of nine months commencing on the interest reset date.

"One-year LIBOR" means the USD-LIBOR-BBA rate with a designated maturity of one year commencing on the interest reset date.

"Twenty-month LIBOR" means the USD-LIBOR-BBA rate with a designated maturity of twenty months commencing on the interest reset date.

If neither LIBOR Reuters nor LIBOR Telerate is specified in the applicable pricing supplement, LIBOR for the applicable index currency will be determined as if LIBOR Telerate were specified, and, if the U.S. dollar is the index currency, as if page 3750 had been specified.

Prime Rate

The "prime rate" means, for any interest determination date, the rate on that date as published in H.15(519) under the heading "Bank Prime Loan".

The following procedures will be followed if the prime rate cannot be determined as described above:

- If the above rate is not published prior to 3:00 p.m., New York City time, on the interest determination date, then the prime rate will be the rate on that interest determination date as published in H.15 Daily Update under the heading "Bank Prime Loan".
- If the rate is not published in either H.15(519) or the H.15 Daily Update by 3:00 p.m., New York City time, on the interest determination date, then the calculation agent will determine the prime rate to be the arithmetic mean of the rates of interest publicly announced by each bank that appears on the Reuters screen USPRIME 1 page, as defined below, as that bank's prime rate or base lending rate as in effect for that interest determination date.
- If fewer than four rates appear on the Reuters screen USPRIME 1 page by 3:00 p.m., New York City time, for that interest determination date, the calculation agent will determine the prime rate to be the arithmetic mean of the prime rates quoted on the basis of the actual number of days in the year divided by 360 as of the close of business on that interest determination date by at least three major banks in The City of New York, which may include affiliates of the agent, selected by the calculation agent, after consultation with us.
- If the banks selected by the calculation agent are not quoting as set forth above, the prime rate for that interest determination date will remain the prime rate for the immediately preceding interest reset period, or, if there was no interest reset period, the rate of interest payable will be the initial interest rate.

"Reuters screen USPRIME 1 page" means the display designated as page "USPRIME 1" on the Reuters Monitor Money Rates Service, or any successor service, or any other page as may replace the USPRIME 1 page on that service for the purpose of displaying prime rates or base lending rates of major U.S. banks.

Treasury Rate

The "Treasury rate" means:

- the rate from the auction held on the applicable interest determination date, which we refer to as the "auction", of direct obligations of the United States, which are commonly referred to as "Treasury Bills", having the index maturity specified in the applicable pricing supplement as that rate appears under the caption "INVESTMENT RATE" on the display on Moneyline Telerate, or any successor service, on page 56 or any other page as may replace page 56 on that service, which we refer to as "Telerate page 56", or page 57 or any other page as may replace page 57 on that service, which we refer to as "Telerate page 57"; or

Table of Contents

- if the rate described in the first bullet point is not published by 3:00 p.m., New York City time, on the interest determination date, the bond equivalent yield of the rate for the applicable Treasury Bills as published in the H.15 Daily Update, or other recognized electronic source used for the purpose of displaying the applicable rate, under the caption "U.S. Government notes/Treasury Bills/Auction High"; or
- if the rate described in the second bullet point is not published by 3:00 p.m., New York City time, on the related interest determination date, the bond equivalent yield of the auction rate of the applicable Treasury Bills, announced by the U.S. Department of the Treasury; or
- if the rate referred to in the third bullet point is not announced by the U.S. Department of the Treasury, or if the auction is not held, the bond equivalent yield of the rate on the applicable interest determination date of Treasury Bills having the index maturity specified in the applicable pricing supplement published in H.15(519) under the caption "U.S. Government notes/Treasury Bills/ Secondary Market"; or
- if the rate referred to in the fourth bullet point is not so published by 3:00 p.m., New York City time, on the related interest determination date, the rate on the applicable interest determination date of the applicable Treasury Bills as published in H.15 Daily Update, or other recognized electronic source used for the purpose of displaying the applicable rate, under the caption "U.S. Government notes/Treasury Bills/Secondary Market"; or
- if the rate referred to in the fifth bullet point is not so published by 3:00 p.m., New York City time, on the related interest determination date, the rate on the applicable interest determination date calculated by the calculation agent as the bond equivalent yield of the arithmetic mean of the secondary market bid rates, as of approximately 3:30 p.m., New York City time, on the applicable interest determination date, of three primary U.S. government securities dealers, which may include the agent and its affiliates, selected by the calculation agent, for the issue of Treasury Bills with a remaining maturity closest to the index maturity specified in the applicable pricing supplement; or
- if the dealers selected by the calculation agent are not quoting as set forth above, the Treasury rate for that interest determination date will remain the Treasury rate for the immediately preceding interest reset period, or, if there was no interest reset period, the rate of interest payable will be the initial interest rate.

The "bond equivalent yield" means a yield calculated in accordance with the following formula and expressed as a percentage:

$$\text{bond equivalent yield} = \frac{(D \times N)}{360 - (D \times M)} \times 100$$

where, "D" refers to the applicable per annum rate for Treasury Bills quoted on a bank discount basis, "N" refers to 365 or 366, as the case may be, and "M" refers to the actual number of days in the interest payment period for which interest is being calculated.

"Treasury spot rate" means the mid-market spot Treasury rate with a designated index maturity specified in the applicable pricing supplement, as determined by the calculation agent, at the time the notes are priced for initial sale to the public, rounded to two decimal places. The continuously reported mid-market spot Treasury rate with a designated index maturity is publicly available on Bloomberg screen "BBT".

"10-year Treasury spot rate" means the USD-Treasury Rate-T500 with a designated maturity of 10 years.

"USD-Treasury Rate-T500" means that the rate for an interest reset date will be a percentage equal to the mid-market yield-to-maturity of the current "on-the-run" U.S. Treasury with a "designated maturity", specified in the applicable pricing supplement, which appears on the Telerate page 500 as of 11:00 a.m., New York City time, on that interest reset date. If that rate does not appear on the Telerate page 500, the rate for that interest reset date will be determined by the calculation agent and will be a percentage equal to the yield-to-maturity based on the secondary market mid-market prices as of 11:00 a.m., New York City time, on that interest reset date of three leading primary

Table of Contents

U.S. government securities dealers in New York City, selected by the calculation agent, (from five of the dealers and eliminating the highest quotation (or, in the event of equality, one of the highest) and the lowest quotation (or, in the event of equality, one of the lowest)) for U.S. Treasury securities with a maturity equal to the designated maturity and taking a simple average of the remaining three values.

"USD-Treasury Rate-T19901" means that the rate for an interest reset date will be a percentage equal to the mid-market yield-to-maturity of the current "on-the-run" U.S. Treasury with a "designated maturity", specified in the applicable pricing supplement, which appears on the Telerate page 19901 as of 11:00 a.m., New York City time, on that interest reset date. If that rate does not appear on the Telerate page 19901, the rate for that interest reset date will be determined by the calculation agent and will be a percentage equal to the yield-to-maturity based on the secondary market mid-market prices as of 11:00 a.m., New York City time, on that interest reset date of three leading primary U.S. government securities dealers in New York City, selected by the calculation agent, (from five of those dealers and eliminating the highest quotation (or, in the event of equality, one of the highest) and the lowest quotation (or, in the event of equality, one of the lowest) for U.S. Treasury securities with a maturity equal to the designated maturity and taking a simple average of the remaining three values.

Market Disruption Event Relating to Notes with a Floating Interest Rate as the Reference Asset

Except as may be provided above in "Reference Assets—Floating Rates", if a reference asset cannot be determined, then the calculation agent will make all determinations.

Securities or "Linked Shares"

The principal, interest or any other amounts payable on the notes may be based on one or more securities, including price movements in or other events relating to those securities, which we refer to as "linked shares". The linked shares may consist of American depositary shares, which are described under "—American Depositary Shares and Deposit Agreements". If a reference asset is comprised of more than one linked share or a linked share and at least one other type of reference asset, the linked share is a "basket component".

Reference Asset Issuer and Reference Asset Information

The notes have not been passed on by the issuer of the linked shares or the issuer of any corresponding ADS underlying shares (as described below) as to their legality or suitability. The notes are not issued, endorsed, sponsored or promoted by and are not financial or legal obligations of the issuer of the linked shares or the issuer of any corresponding ADS underlying shares. The trademarks, service marks or registered trademarks of the issuer of the linked shares or the issuer of any corresponding ADS underlying shares. are the property of their owner. The issuer of the reference asset makes no warranties and bears no liabilities with respect to the notes or to the administration or operation of the notes. This prospectus supplement relates only to the notes offered by the applicable pricing supplement and does not relate to any security of an underlying issuer.

If the reference asset is a linked share that is registered under the Securities Exchange Act of 1934, as amended, which is commonly referred to as the "Exchange Act", issuers of those linked shares are required to file periodically financial and other information specified by the SEC. Information provided to or filed with the SEC can be inspected and copied at the public reference facilities maintained by the SEC at Room 1580, 100 F Street, N.E., Washington, D.C. 20549, and copies of that material can be obtained from the Public Reference Section of the SEC, 100 F Street, N.E., Washington, D.C. 20549, at prescribed rates. You may obtain information on the operation of the public reference room by calling the SEC at l-800-SEC-0330. In addition, information provided to or filed with the SEC electronically can be accessed through a website maintained by the SEC. The address of the SEC's website is http://www.sec.gov. Information provided to or filed with the SEC pursuant to the Exchange Act by a company issuing a linked share can be located by reference to the SEC file number provided in the applicable pricing supplement. In addition, information regarding a company issuing a linked share may be obtained from other sources including, but not limited to, press releases, newspaper articles and other publicly

Table of Contents

disseminated documents. We make no representation or warranty as to the accuracy or completeness of the information referred to above relating to linked shares or any other publicly available information regarding the issuer of the reference asset. Neither we nor the agent has participated in the preparation of the above-described documents or made any due diligence inquiry with respect to the issuer of the reference asset. Furthermore, we cannot give any assurance that all events occurring prior to the date of the applicable pricing supplement (including events that would affect the accuracy or completeness of the publicly available documents described herein) that would affect the closing prices of the reference asset (and therefore the closing price of that reference asset at the time we price the notes) have been publicly disclosed. Subsequent disclosure of any of those events or the disclosure of or failure to disclose material future events concerning the issuer of the reference asset could affect the value received at maturity with respect to the notes and therefore the price of the notes in the secondary market, if any.

Special Calculation Provisions

With respect to reference assets that are linked shares, the closing price for any security on any day will equal the closing sale price or last reported sale price, regular way, for the security, on a per-share or other unit basis:

- on the principal national securities exchange on which that security is listed for trading on that day, or
- if that security is not listed on any national securities exchange, on any other U.S. national market system that is the primary market for the trading of that security.

With respect to the closing sale price or last reported sale price for the NASDAQ, the closing price will be the Nasdaq Official Closing Price (NOCP) unless otherwise specified in the applicable pricing supplement.

If that security is not listed or traded as described above, then the closing price for that security on any day will be determined by the calculation agent. In determining the closing price for that security on any day, the calculation agent may consider any relevant information, including, without limitation, information consisting of relevant market data in the relevant market supplied by one or more third parties or internal sources including, without limitation, relevant rates, prices, yields, yield curves, volatiles, spreads, correlations or other relevant market data in the relevant market.

American Depositary Shares and Deposit Agreements

Any linked share in the form of an American depositary share is issued pursuant to a deposit agreement, as amended from time to time (the "deposit agreement"). An event that has a diluting or concentrative effect on the corresponding ADS underlying shares may affect the theoretical value of those linked shares unless (and to the extent that) the issuer of the ADS underlying shares or the depository for the linked shares, pursuant to their authority (if any) under the deposit agreement, elects to adjust the number of ADS underlying shares that are represented by each linked share such that the price and other terms of the linked share will not be affected by any such event. If the issuer of the ADS underlying shares or the depository for the linked share does not adjust the number of ADS underlying shares that are represented by each linked share, or makes an adjustment that the calculation agent deems inappropriate to account for such an event, then the calculation agent may make any adjustments that the calculation agent determines to be appropriate to account for that event. The depository of the linked shares may also have the ability pursuant to the deposit agreement to make adjustments in respect of the linked shares for share distributions, rights distributions, cash distributions and distributions other than shares, rights and cash. Upon any such adjustment by the depository, the calculation agent may adjust such terms and conditions of the notes as the calculation agent determines appropriate to account for that event.

"ADS underlying shares" means with respect to a reference asset that is an American depositary share, the securities of the issuer underlying that reference asset.

Market Disruption Events Relating to Notes with an Equity Security as the Reference Asset

For purposes of this subsection "Market Disruption Events Relating to Notes with an Equity Security as the Reference Asset", all references to "linked shares" include any corresponding ADS underlying shares unless otherwise specified. Any of the following will be a market disruption event where the reference asset is a linked share:

- a suspension, absence or limitation of trading in (i) linked shares in their primary market, as determined by the calculation agent, or (ii) futures or options contracts relating to the linked shares in the primary market for those contracts, as determined by the calculation agent;

Table of Contents

- any event that disrupts or impairs, as determined by the calculation agent, the ability of market participants to (i) effect transactions in, or obtain market values for, the linked shares in their primary market, or (ii) effect transactions in, or obtain market values for, futures or options contracts relating to the linked shares in their primary market;
- the closure on any day of the primary market for the linked shares where the primary market is scheduled to be open for trading for its regular trading session (a "scheduled trading day") prior to the scheduled weekday closing time of that market (without regard to after hours or any other trading outside of the regular trading session hours) unless the earlier closing time is announced by the primary market at least one hour prior to the earlier of (i) the actual closing time for the regular trading session on such primary market on such scheduled trading day for such primary market and (ii) the submission deadline for orders to be entered into the relevant exchange system for execution at the close of trading on such scheduled trading day for such primary market;
- any scheduled trading day on which (i) the primary market for the linked shares or (ii) the exchanges or quotation systems, if any, on which futures or options contracts on the linked share, fails to open for trading during its regular trading session; or
- any other event, if the calculation agent determines that the event interferes with our ability or the ability of any of our affiliates to unwind all or a portion of a hedge with respect to the notes that we or our affiliates have effected or may effect as described below under "Use of Proceeds and Hedging" in this prospectus supplement.

and, in any of these events, the calculation agent determines that the event was material.

The following events will not be market disruption events:

- a limitation on the hours or numbers of days of trading, but only if the limitation results from an announced change in the regular business hours of the relevant market; or
- a decision to permanently discontinue trading in the futures or options contracts relating to the linked shares.

For this purpose, an "absence of trading" in the primary securities market on which futures or options contracts related to the linked shares are traded will not include any time when that market is itself closed for trading under ordinary circumstances.

In contrast, a suspension or limitation of trading in linked shares, or in futures or options contracts related to the linked shares, in their primary markets, by reason of any of:

- a price change exceeding limits set by that market,
- an imbalance of orders, or
- a disparity in bid and ask quotes,

will constitute a suspension or material limitation of trading.

If the calculation agent determines that a market disruption event occurs or is continuing on any valuation date, the valuation date will be the first following business day on which the calculation agent determines that a market disruption event does not occur and is not continuing. In no event, however, will the valuation date be postponed by more than five business days. If the calculation agent determines that a market disruption event occurs or is continuing on the fifth business day, the calculation agent will make an estimate of the closing price for the linked share that would have prevailed on that fifth business day in the absence of the market disruption event.

Table of Contents

If the linked share is a basket component and the calculation agent determines that a market disruption event occurs or is continuing with respect to a linked share on any basket valuation date, the respective date will be postponed as described under "Reference Assets—Baskets—Market Disruption Events".

Share Adjustments Relating to Notes with an Equity Security as the Reference Asset

For purposes of this subsection "Share Adjustments Relating to Notes with an Equity Security as the Reference Asset", all references to "linked shares" include any corresponding ADS underlying shares unless otherwise specified.

Antidilution Adjustments.

The calculation agent may adjust any variable described in the applicable pricing supplement, including but not limited to, if applicable, any price (including but not limited to the initial price, final price, barrier price and strike price), barrier percentage, physical delivery amount, any combination thereof or any other variable described in the applicable pricing supplement, if an event described below occurs on or before the final valuation date (or final observation or final averaging date) and the calculation agent determines that the event has a diluting or concentrative effect on the theoretical value of the linked shares.

The adjustments described below do not cover all events that could affect the market value of the notes.

How Adjustments Will Be Made. If one of the events described below occurs on or before the final valuation date (or final observation or final averaging date) and the calculation agent determines that the event has a diluting or concentrative effect on the theoretical value of the linked shares, the calculation agent may calculate a corresponding adjustment to any variable described in the applicable pricing supplement, including but not limited to, if applicable, any price (including but not limited to the initial price, final price, barrier price and strike price) barrier percentage, physical delivery amount, any combination thereof, as the calculation agent determines appropriate to account for that diluting or concentrative effect. For example in the case of a reverse convertible note, if an adjustment is required because of a two-for-one stock split, then the physical delivery amount for the notes will be adjusted to double the prior physical delivery amount, and, as a result, the initial price and protection price will be halved. The calculation agent will also determine the effective date of that adjustment. Upon making any adjustment of that kind, the calculation agent will provide written notice to the trustee, and the trustee will furnish written notice thereof, to the extent the trustee is required to under the senior debt indenture, to each noteholder, or in the case of global notes, the depositary, as holder of the global notes, stating the adjustment made.

If more than one event requiring adjustment occurs, the calculation agent will make such an adjustment for each event in the order in which the events occur, and on a cumulative basis. Thus, having adjusted the values for the appropriate variables for the first event, the calculation agent will adjust the appropriate values for the second event, applying the required adjustments cumulatively.

For any dilution event described below, the calculation agent will not have to adjust any variable unless the adjustment would result in a change of at least 0.1% of the unadjusted amount. The values of the variables, including but not limited to, if applicable, any price (including but not limited to the initial price, final price, barrier price and strike price), barrier percentage, physical delivery amount, any combination thereof or any other variable described in the applicable pricing supplement, resulting from any adjustment will be rounded up or down, as appropriate, See "Description of Medium-Term Notes—Calculations and Calculation Agent".

The calculation agent will make all determinations with respect to antidilution adjustments, including any determination as to whether an event requiring adjustment has occurred, as to the nature of the adjustment required and how it will be made. The calculation agent will provide information about any adjustments it makes upon your written request.

The following events are those that may require an antidilution adjustment, in each case, if that event occurs on or before the final valuation date (or final observation or final averaging date):

- a subdivision, consolidation or reclassification of the linked shares or a free distribution or dividend of any of these shares to existing holders of the shares by way of bonus, capitalization or similar issue;

Table of Contents

- a distribution or dividend to existing holders of the linked shares of:
  - linked shares,
  - other share capital or securities granting the right to payment of dividends and/or proceeds of a liquidation of the issuer of the linked shares equally or proportionately with such payments to holders of the linked shares,
  - share capital or other securities of another issuer acquired or owned or owned (directly or indirectly) by the issuer of linked shares as a result of a spin-off or other similar type transaction; or
  - any other type of securities, rights or warrants or other assets in any case for payment (in cash or otherwise) at less than the prevailing market price as determined by the calculation agent;
- the declaration by the issuer of the linked shares of an extraordinary or special dividend or other distribution whether in cash or linked shares or other assets;
- a call by the issuer of linked shares in respect of linked shares that are not fully paid;
- in respect of an issuer of linked shares, an event that results in any shareholder rights being distributed or becoming separated from shares of common stock or other shares of capital stock of the issuer of linked shares pursuant to a shareholder rights plan or arrangement directed against hostile takeovers that provides upon the occurrence of certain events for a distribution of preferred stock, warrants, debt instruments or stock rights at a price below their market value, as determined by the calculation agent, provided that any adjustment effected as a result of such an event shall be readjusted upon any redemption of such rights;
- a repurchase by the issuer of the linked shares of its common stock whether out of profits or capital and whether the consideration for that repurchase is cash, securities or otherwise; or
- any other similar event that may have a diluting or concentrative effect on the theoretical value of the linked shares.

Stock Splits. A stock split is an increase in the number of a corporation's outstanding shares of stock without any change in its stockholders' equity. Each outstanding share is worth less as a result of a stock split.

For example, in the case of a reverse convertible note where the linked shares are subject to a stock split, the calculation agent will adjust the physical delivery amount to equal the sum of the physical delivery amount before that adjustment (the "prior physical delivery amount") plus the product of (1) the number of new shares issued in the stock split with respect to one linked share and (2) the prior physical delivery amount. The initial price, protection price and any other variable that the calculation agent determines is appropriate to account for the related dilutive or concentrative effect will also be adjusted as discussed above.

Reverse Stock Splits

A reverse stock split is a decrease in the number of a corporation's outstanding shares of stock without any change in its stockholders' equity. Each outstanding share is worth more as a result of a reverse stock split.

For example, in the case of a reverse convertible note where the linked shares are subject to a reverse stock split, then the calculation agent will adjust the physical delivery amount to equal the product of the prior physical delivery amount and the quotient of (1) the number of linked shares outstanding immediately after the reverse stock split becomes effective and (2) the number of linked shares outstanding immediately before the reverse stock split becomes effective. The initial price and protection price will also be adjusted as discussed above.

Table of Contents

Extraordinary Dividends

A dividend or other distribution with respect to the linked shares will be deemed to be an "extraordinary dividend" if, as determined by the calculation agent, it is (i) a payment by the issuer of linked shares to holders of the linked shares that such issuer announces will be an extraordinary dividend; (ii) a payment by the issuer of the linked shares to holders of these shares out of that issuer's capital and surplus; or (iii) any other "special" cash or non-cash dividend on, or distribution with respect to, the linked shares which is, by its terms or declared intent, declared and paid outside the normal operations or normal dividend procedures of the relevant issuer. The ex-dividend date for any dividend or other distribution is the first day on which the linked shares trade without the right to receive that dividend or distribution.

To the extent an extraordinary dividend is not paid in cash, the value of the non-cash component will be determined by the calculation agent. If an extraordinary dividend occurs on or before the final valuation date (or final observation or final averaging date) occurs and the calculation agent determines that such event has a diluting or concentrative effect on the theoretical value of the linked shares, the calculation agent will adjust any variables it determines appropriate to account for that diluting or concentrative effect.

Reorganization Events

Each of the following is a reorganization event in respect of the linked shares, provided *that*, in each case, the closing date of the event occurs on or before the final valuation date (or final observation or final averaging date):

- any reclassification or change of the linked shares that results in the transfer of or an irrevocable commitment to transfer all of the outstanding linked shares to another person or entity;
- the linked shares have been subject to a merger, consolidation, amalgamation or binding share exchange which is not a merger, consolidation, amalgamation or binding share exchange in which the issuer of the linked shares is the surviving entity and which does not result in the reclassification or change of all of the outstanding linked shares;
- any takeover offer, tender offer, exchange offer, solicitation, proposal or other event by any entity or person that results in that entity or person purchasing, or otherwise obtaining or having the right to obtain, by conversion or other means, not less than 100% of the outstanding voting linked shares (other than the shares of the linked shares owned or controlled by that other entity or person) as determined by the calculation agent, based upon the making of filings with governmental or self-regulatory agencies or any other information as the calculation agent deems relevant;
- any consolidation, amalgamation, merger or binding share exchange of the issuer of the linked shares or its subsidiaries with or into another entity in which the issuer of the linked shares is the continuing entity and which does not result in a reclassification or change of all such outstanding linked shares but results in the outstanding linked shares (other than the linked shares owned or controlled by that other entity) immediately prior to that event collectively representing less than 50% of the outstanding linked shares immediately following that event; or
- any takeover offer, tender offer, exchange offer, solicitation, proposal or other event by any entity or person that results in that entity or person purchasing, or otherwise obtaining or having the right to obtain, by conversion or other means, not less than 10% of the outstanding voting linked shares (other than the shares of the linked shares owned or controlled by that other entity or person) as determined by the calculation agent, based upon the making of filings with governmental or self-regulatory agencies or any other information as the calculation agent deems relevant.

Adjustments for Reorganization Events.

For purposes of this subsection "Adjustments for Reorganization Events", references to "linked shares" do not include the corresponding ADS underlying shares.

If a reorganization event occurs with respect to the linked shares or any corresponding ADS underlying shares and the consideration for the linked shares consists solely of new shares (exclusive of fractional share cash amounts) that

Table of Contents

are publicly quoted, traded or listed on any of the New York Stock Exchange, the American Stock Exchange or the NASDAQ (or their respective successors), then the shares of the linked shares will be adjusted to comprise the new number of shares to which a holder of one share of the linked shares immediately prior to the occurrence of the reorganization event, as the case may be, would be entitled upon consummation of that reorganization event, and the calculation agent shall adjust any variable that the calculation agent determines appropriate to account for the reorganization event.

If the new shares offered as consideration for the shares of the linked shares are not publicly quoted, traded or listed on any of the New York Stock Exchange, the American Stock Exchange or the NASDAQ (or their respective successors), then the calculation agent shall accelerate the maturity date to the day which is four business days after the approval date (as described below) and the calculation agent shall calculate the market value of the notes (inclusive of the value of the imbedded options) that would preserve for you the economic equivalent of any remaining payment obligations with respect to the notes hereunder. For purposes of that calculation, the final price will be determined by the calculation agent and will be deemed to be the value of all consideration received (or that would be received) in respect of that reorganization event and the final valuation date (or final observation or final averaging date) will be deemed to occur on the approval date. The “approval date” shall mean the closing date with respect to each of the first four reorganization events described above or the date on which the person or entity making the offer, solicitation or proposal acquires the right to obtain the relevant percentage of linked shares with respect to the fifth reorganization event described above, as the case may be.

If a reorganization event occurs and the consideration for the linked shares consists (i) solely of cash and assets and other securities (other than new linked shares as discussed above), or (ii) of new linked shares plus cash and assets, then the calculation agent shall accelerate the maturity date to the day which is four business days after the approval date (as described above) and the calculation agent shall calculate the market value of the notes (inclusive of the value of the imbedded options) that would preserve for you the economic equivalent of any remaining payment obligations with respect to the notes hereunder. For purposes of that calculation, the final price will be determined by the calculation agent and will be deemed to be the value of all consideration received (or that would be received) in respect of that reorganization event and the final valuation date (or final observation or final averaging date) will be deemed to be the approval date.

In the case of an acceleration of the maturity date, any interest payable under the notes will be paid through and excluding the related date of the accelerated payment. If a holder of a linked share or any corresponding ADS underlying shares elects to receive different types or combinations of property in the reorganization event, that property will consist of the types and amounts of each type distributed to a holder that makes no election, as determined by the calculation agent.

For any reorganization event described above, the calculation agent will not have to adjust any variable or combination of variables unless the adjustment would result in a change of at least 0.1% of the unadjusted amount. The values of variables resulting from any adjustment will be rounded up or down, as appropriate, in the case of any price, the nearest cent, in the case of the physical delivery amount, the nearest thousandth, and in the case of any percentages, the nearest hundredth of a percent, with one half cent, five hundred thousandths and five hundredth of a percent, respectively, being rounded upward.

If a reorganization event requiring adjustment occurs, the calculation agent will make any adjustments with a view to offsetting, to the extent practical, any change in your economic position relative to the notes, that results solely from that event. The calculation agent may modify any adjustments as necessary to ensure an equitable result.

Additional Adjustment Events.

For purposes of this subsection “Additional Adjustment Events”, references to linked shares do not include the corresponding ADS underlying shares.

Each of the following is an additional adjustment event in respect of the linked shares, or any corresponding ADS underlying shares provided *that*, in each case, the event occurs on or before the final valuation date (or final observation or final averaging date):

- All the assets or substantially all the assets of the issuer of the linked shares or any corresponding ADS underlying shares are nationalized, expropriated or are otherwise required to be transferred to any governmental agency, authority or entity.

Table of Contents

- By reason of the voluntary or involuntary liquidation, bankruptcy or insolvency of, or any analogous proceeding involving the issuer of the linked shares, or any corresponding ADS underlying shares (i) all of the shares of the issuer of the linked shares or the issuer of any corresponding ADS underlying shares are required to be transferred to a trustee, liquidator or other similar official or (ii) holders of the linked shares or any corresponding ADS underlying shares become legally prohibited from transferring those shares.
- The exchange on which the linked shares are traded announces that pursuant to the rules of that exchange, the linked shares cease (or will cease) to be listed, traded or publicly quoted on that exchange for any reason (other than a reorganization event as described above) and those linked shares are not immediately re-listed, re-traded or re-quoted on any of the New York Stock Exchange, the American Stock Exchange or the NASDAQ (or their respective successors).

If an additional adjustment event relating to the linked shares or any corresponding ADS underlying shares occurs on or before the final valuation date (or final observation or final averaging date), the calculation agent may accelerate the maturity date to the day which is four business days after the announcement date (as described below). In the event of such an acceleration, on the maturity date, we shall pay to you the amount payable at maturity and for the purposes of that calculation, the final price will be determined by the calculation agent and the final valuation date (or final observation or final averaging date) will be deemed to be the price on the business day immediately prior to the announcement date. The “announcement date” means, for purposes of this paragraph, (i) in the case of the additional adjustment event first described above, the day of the first public announcement by the relevant government authority that all or substantially all of the assets of the issuer of the linked shares or the issuer of any corresponding ADS underlying shares are to be nationalized, expropriated or otherwise transferred to any governmental agency, authority or entity, (ii) in the case of the second additional adjustment event described above, the day of the first public announcement of the institution of a proceeding or presentation of a petition or passing of a resolution (or other analogous procedure in any jurisdiction) that leads to an insolvency with respect to the issuer of the linked shares or any corresponding ADS underlying shares, or (iii) in the case of the third additional adjustment event described above, the day of the first public announcement by the relevant exchange that the shares of the linked shares will cease to trade or be publicly quoted on that exchange. The calculation agent shall then calculate the market value of the notes (inclusive of the value of the imbedded options) that would preserve for you the economic equivalent of any remaining payment obligations with respect to the notes hereunder.

In the case of an acceleration of the maturity date, any interest payable under the notes will be paid through and excluding the related date of the accelerated payment. In the case where an additional adjustment event relating to the linked shares or any corresponding ADS underlying shares occurs on or before the final valuation date (or final observation or final averaging date) and the calculation agent does not accelerate the maturity date, the calculation agent may adjust any variable the calculation agent determines appropriate to account for that additional adjustment event.

Indices

The principal, interest or any other amounts payable on the notes may be based on one or more indices, including movements in the levels of the indices, the prices of their components or other events relating to that index. The index or indices that comprise the reference asset shall be specified in the applicable pricing supplement. If a reference asset is comprised of more than one index or an index and at least one other type of asset, the index is a “basket component”.

Table of Contents

Reference Asset Sponsor and Reference Asset Information

The notes have not been passed on by the sponsor of the reference asset as to their legality or suitability. The notes are not issued, endorsed, sponsored or promoted by and are not financial or legal obligations of the sponsor of the reference asset. The trademarks, service marks or registered trademarks of the sponsor of the reference asset are the property of their owner. The sponsor of the reference asset makes no warranties and bears no liabilities with respect to the notes or to the administration or operation of the notes. This prospectus supplement relates only to the notes offered by the applicable pricing supplement and does not relate to any index of a sponsor.

Information regarding a reference asset comprised of an index or the sponsor of the reference asset may be obtained from various public sources including, but not limited to, press releases, newspaper articles, the sponsor website and other publicly disseminated documents. We make no representation or warranty as to the accuracy or completeness of the information referred to above relating to the reference asset or any other publicly available information regarding the sponsor of the reference asset. In connection with any issuance of notes under this prospectus supplement, neither we nor the agent has participated in the preparation of the above-described documents or made any due diligence inquiry with respect to the sponsor of the reference asset. Furthermore, we cannot give any assurance that all events occurring prior to the date of the applicable pricing supplement (including events that would affect the accuracy or completeness of the publicly available documents described herein) that would affect the levels of the reference asset (and therefore the levels of the reference asset at the time we price the notes) have been publicly disclosed. Subsequent disclosure of any such events or the disclosure of or failure to disclose material future events concerning the sponsor of the reference asset could affect the interest, payments at maturity or any other amounts payable on your notes and therefore the market value of the notes in the secondary market, if any.

Market Disruption Events for Notes with the Reference Asset Comprised of an Index or Indices

Valuation dates may be postponed and thus the determination of the index levels may be postponed if the calculation agent determines that, on the respective date, a market disruption event has occurred or is continuing in respect of an index.

Any equity security, interest rate, currency exchange rate, currency, commodity or other asset or variable that comprises an index is herein referred to as an “index component”.

Any of the following will be a market disruption event with respect an index:

- a suspension, absence or limitation of trading in index components constituting 20% or more, by weight, of that index;
- a suspension, absence or limitation of trading in futures or options contracts relating to that index on their respective markets;
- any event that disrupts or impairs, as determined by the calculation agent, the ability of market participants to (i) effect transactions in, or obtain market values for, index components constituting 20% or more, by weight, of that index, or (ii) effect transactions in, or obtain market values for, futures or options contracts relating to that index on their respective markets;
- the closure on any day of the primary market for futures or options contracts relating to that index or index components constituting 20% or more, by weight, of that index on a scheduled trading day prior to the scheduled weekday closing time of that market (without regard to after hours or any other trading outside of the regular trading session hours) unless such earlier closing time is announced by the primary market at least one hour prior to the earlier of (i) the actual closing time for the regular trading session on such primary market on such scheduled trading day for such primary market and (ii) the submission deadline for orders to be entered into the relevant exchange system for execution at the close of trading on such scheduled trading day for such primary market;

Table of Contents

- any scheduled trading day on which (i) the primary markets for index components constituting 20% or more, by weight, of that index or (ii) the exchanges or quotation systems, if any, on which futures or options contracts on that index are traded, fails to open for trading during its regular trading session; or
- any other event, if the calculation agent determines that the event interferes with our ability or the ability of any of our affiliates to unwind all or a portion of a hedge with respect to the notes that we or our affiliates have effected or may effect as described below under "Use of Proceeds and Hedging" in this prospectus supplement.

and, in any of these events, the calculation agent determines that the event was material.

The following event will not be a market disruption event:

- a limitation on the hours or number of days of trading on which any index component is traded, but only if the limitation results from an announced change in the regular business hours of the relevant market; or
- a decision to permanently discontinue trading in futures or options contracts relating to an index.

For this purpose, an "absence of trading" on an exchange or market will not include any time when the relevant exchange or market is itself closed for trading under ordinary circumstances.

In contrast, a suspension or limitation of trading in futures or options contracts related to the index, if available, in the primary market for those contracts, by reason of any of:

- a price change exceeding limits set by that market,
- an imbalance of orders relating to those contracts, or
- a disparity in bid and ask quotes relating to those contracts,

will constitute a suspension or material limitation of trading in futures or options contracts related to an index in the primary market for those contracts.

If the calculation agent determines that a market disruption event occurs or is continuing on any valuation date, the valuation date will be the first following business day on which the calculation agent determines that a market disruption event does not occur and is not continuing. In no event, however, will the valuation date be postponed by more than five business days. If the calculation agent determines that a market disruption event occurs or is continuing on the fifth business day, the calculation agent will make an estimate of the closing level for the reference asset that would have prevailed on that fifth business day in the absence of the market disruption event.

If the index is a basket component and the calculation agent determines that a market disruption event occurs or is continuing with respect to the index on any basket valuation date, the respective date will be postponed as described under "Reference Assets—Baskets—Market Disruption Events".

Adjustments Relating to Notes with the Reference Asset Comprised of an Index

If any sponsor discontinues publication of or otherwise fails to publish any index comprising the reference asset and that sponsor or another entity publishes a successor or substitute index that the calculation agent determines to be comparable to the discontinued index (that index being referred to herein as a "successor index"), then the level will be determined by reference to the level of that successor index on the date as of which that level is to be determined.

Upon any selection by the calculation agent of a successor index, the calculation agent will provide written notice to the trustee thereof, and the trustee will furnish written notice thereof, to the extent the trustee is required to under the senior debt indenture, to each noteholder, or in the case of global notes, the depositary, as holder of the global notes.

If a successor index is selected by the calculation agent, the successor index will be used as a substitute for the reference asset for all purposes, including for purposes of determining whether a market disruption event exists with respect to that index.

If (i) the index is discontinued or (ii) a sponsor fails to publish the index, in either case, prior to

Table of Contents

(and that discontinuance is continuing on) a valuation date and the calculation agent determines that no successor or substitute index is available at that time, then the calculation agent will determine the value to be used for the level. The value to be used for the level will be computed by the calculation agent in the same general manner previously used by the related sponsor and will reflect the performance of that index through the business day on which that index was last in effect preceding such date of discontinuance. In that case, the calculation agent will treat any business day on which the primary exchange for futures or options contracts relating to that index is open for trading as a business day for that index for purposes of the determination of the final level. In that event, the calculation agent will provide written notice to the trustee thereof, and the trustee will furnish written notice thereof, to the extent the trustee is required to under the senior debt indenture, to each noteholder, or in the case of global notes, the depositary, as holder of the global notes.

Notwithstanding these alternative arrangements, discontinuance of the publication of any index comprising the reference asset may adversely affect the value of, and trading in, the notes.

If at any time, there is:

- a material change in the formula for or the method of calculating the level of the reference asset, an index comprising the reference asset, or a successor index;
- a material change in the content, composition or constitution of the reference asset, an index comprising the reference asset or a successor index;
- a change or modification to the reference asset or a successor index such that the reference asset or successor index does not, in the opinion of the calculation agent, fairly represent the value of that reference asset or successor index had those changes or modifications not been made, or
- any other event, if the calculation agent determines that the event materially interferes with our ability or the ability of any of our affiliates to unwind all or a material portion of a hedge with respect to the notes that we or our affiliates have effected or may effect as described below under “Use of Proceeds and Hedging” in this prospectus supplement.

then, for purposes of calculating the level of the index, any payments on the notes or making any other determinations as of or after that time, the calculation agent will make those calculations and adjustments as the calculation agent determines may be necessary in order to arrive at a level for the index comparable to such index or such successor index, as the case may be, as if those changes or modifications had not been made, and calculate the amount of interest, payment at maturity and other amounts payable on the note (including the individual inputs thereof) with reference to such index or such successor index, as adjusted. In that event, the calculation agent will provide written notice to the trustee thereof, and the trustee will furnish written notice thereof, to the extent the trustee is required to under the senior debt indenture, to each noteholder, or in the case of global notes, the depositary, as holder of the global notes.

The calculation agent will make all determinations with respect to adjustments, including any determination as to whether an event requiring adjustment has occurred, as to the nature of the adjustment required and how it will be made. The calculation agent will provide information about any adjustments it makes upon your written request.

Commodities

The principal, interest or any other amounts payable on the notes may be based on a commodity, including price or level movements in or other events relating to those commodities. If a reference asset is comprised of more than one commodity or a commodity and at least one other type of asset, the commodity is a “basket component”.

Commodities Futures Markets

Futures contracts on physical commodities and commodity indices are traded on regulated futures exchanges, and physical commodities and other derivatives on physical commodities and commodity indices are traded in the over-the-counter market and on various types of physical and electronic trading facilities and markets. An exchange-traded futures contract provides for the purchase and sale of a specified

Table of Contents

type and quantity of a commodity or financial instrument during a stated delivery month for a fixed price. A futures contract on an index of commodities provides for the payment and receipt of cash based on the level of the index at settlement or liquidation of the contract. A futures contract provides for a specified settlement month in which the cash settlement is made or in which the commodity or financial instrument is to be delivered by the seller (whose position is therefore described as “short”) and acquired by the purchaser (whose position is therefore described as “long”).

There is no purchase price paid or received on the purchase or sale of a futures contract. Instead, an amount of cash or cash equivalents must be deposited with the broker as “initial margin”. This amount varies based on the requirements imposed by the exchange clearing houses. This margin deposit provides collateral for the obligations of the parties to the futures contract.

By depositing margin, which may vary in form depending on the exchange, with the clearing house or broker involved, a market participant may be able to earn interest on its margin funds, thereby increasing the total return that it may realize from an investment in futures contracts. The market participant normally makes to, and receives from, the broker subsequent daily payments as the price of the futures contract fluctuates. These payments are called “variation margin” and are made as the existing positions in the futures contract become more or less valuable, a process known as “marking to the market”.

Futures contracts are traded on organized exchanges, known as “contract markets” in the United States. At any time prior to the expiration of a futures contract, subject to the availability of a liquid secondary market, a trader may elect to close out its position by taking an opposite position on the exchange on which the trader obtained the position. This operates to terminate the position and fix the trader’s profit or loss. Futures contracts are cleared through the facilities of a centralized clearing house and a brokerage firm, referred to as a “futures commission merchant”, which is a member of the clearing house. The clearing house guarantees the performance of each clearing member that is a party to a futures contract by, in effect, taking the opposite side of the transaction. Clearing houses do not guarantee the performance by clearing members of their obligations to their customers.

Unlike equity securities, futures contracts, by their terms, have stated expirations and, at a specified point in time prior to expiration, trading in a futures contract for the current delivery month will cease. As a result, a market participant wishing to maintain its exposure to a futures contract on a particular commodity with the nearest expiration must close out its position in the expiring contract and establish a new position in the contract for the next delivery month, a process referred to as “rolling”. For example, a market participant with a long position in November crude oil futures that wishes to maintain a position in the nearest delivery month will, as the November contract nears expiration, sell November futures, which serves to close out the existing long position, and buy December futures. This will “roll” the November position into a December position, and, when the November contract expires, the market participant will still have a long position in the nearest delivery month.

Futures exchanges and clearing houses in the United States are subject to regulation by the Commodities Futures Trading Commission. Exchanges may adopt rules and take other actions that affect trading, including imposing speculative position limits, maximum price fluctuations and trading halts and suspensions and requiring liquidation of contracts in some circumstances. Futures markets outside the United States are generally subject to regulation by comparable regulatory authorities. The structure and nature of trading on non-U.S. exchanges, however, may differ from this description.

Settlement Price

The official U.S. dollar cash buyer settlement price for each commodity will be determined as described below.

(a) where the commodity is gold, the afternoon Gold fixing price per troy ounce of unallocated Gold bullion for delivery in London through a member of the London Bullion Market Association (“LBMA”) authorized to effect such delivery, stated in U.S. dollars, as calculated by the LBMA;

Table of Contents

(b) where the commodity is silver, the Silver fixing price per troy ounce of unallocated Silver bullion for delivery in London through a member of the LBMA authorized to effect such delivery, stated in U.S. dollars, as calculated by the LBMA;

(c) where the commodity is platinum, the afternoon Platinum fixing price per troy ounce of unallocated Platinum bullion for delivery in Zurich through a member of the London Platinum and Palladium Market ("LPPM") authorized to effect such delivery, stated in U.S. dollars, as calculated by the LPPM;

(d) where the commodity is palladium, the afternoon Palladium fixing price per troy ounce of unallocated Palladium bullion for delivery in Zurich through a member of the LPPM authorized to effect such delivery, stated in U.S. dollars, as calculated by the LPPM

(e) where the commodity is aluminum, the official settlement price per tonne of high grade primary aluminum on the London Metal Exchange ("LME") for cash delivery, as stated in U.S. dollars, as determined by the LME;

(f) where the commodity is copper, the official settlement price per tonne of copper-Grade A on the LME for cash delivery, stated in U.S. dollars, as determined by the LME;

(g) where the commodity is lead, the official settlement price per tonne of Standard Lead on the LME for cash delivery, stated in U.S. dollars, as determined on the LME;

(h) where the commodity is nickel, the official settlement price per tonne of Primary Nickel on the LME for cash delivery, stated in U.S. dollars, as determined by the LME;

(i) where the commodity is tin, the official settlement price per tonne of Tin on the LME for cash delivery, stated in U.S. dollars, as determined by the LME;

(j) where the commodity is zinc, the official settlement price per tonne of Special High Grade Zinc on the LME for cash delivery, as stated in U.S. dollars, as determined by the LME;

(k) where the commodity is WTI Crude, the closing settlement price per barrel of West Texas Intermediate light sweet crude oil on the New York Mercantile Exchange ("NYMEX") of the futures contract in respect of the first nearby month, stated in U.S. dollars, as made public by the NYMEX;

(l) where the commodity is brent crude, the closing settlement price per barrel of brent blend crude oil on the International Petroleum Exchange ("IPE") of the futures contract in respect of the first nearby month, stated in U.S. Dollars, as made public by the IPE;

(m) where the commodity is heating oil, the closing settlement price per gallon of New York Harbor No. 2 heating oil on the NYMEX of the futures contract in respect of the first nearby month, stated in U.S. dollars, as made public by the NYMEX;

(n) where the commodity is gas oil, the closing settlement price per metric ton of gas oil on the IPE of the futures contract in respect of the first nearby month, stated in U.S. dollars, as made public by the IPE;

(o) where the commodity is unleaded gasoline, the closing settlement price per gallon of New York Harbor unleaded gasoline on the NYMEX of the futures contract in respect of the first nearby month, stated in U.S. dollars, as made public by the NYMEX;

(p) where the commodity is Gasoline RBOB, the closing settlement price per gallon of New York Harbor Gasoline Blendstock for Oxygen Blending on the NYMEX of the Futures Contract for the Delivery Date, stated in U.S. Dollars, as made public by the NYMEX;

(q) where the commodity is natural gas, the closing settlement price per MMBTU of natural gas on the NYMEX of the Henry Hub Natural Gas futures contract in respect of the first nearby month, stated in U.S. Dollars, as made public by NYMEX;

(r) where the commodity is coal, the official price per tonne of steam coal 6,000 kcal/kg, up to 1% sulphur NAR basis, cif ARA, stated in U.S. Dollars, published under the heading "International Coal Indexes incorporating the TFS API(TM) Indices: Monthly Coal Price Indexes: TFS API 2 (cif ARA)" for the preceding calendar month in the issue of Argus/McCloskey's Coal Price Index Report that reports prices effective on that pricing date; and

Table of Contents

(s) where the commodity is German Electricity, the official closing price per MWh of electricity on the European Energy Exchange ("EEX") of the Phelix Baseload Year futures contract in respect of the first nearby full year, in Euros, as made public by the EEX.

Market Disruption Events Relating to Notes with a Commodity as the Reference Asset

Any of the following will be a market disruption event with respect to a commodity:

- a suspension, absence or limitation of trading in (i) that commodity in its primary market, as determined by the calculation agent, or (ii) futures or options contracts relating to that commodity in the primary market for those contracts, as determined by the calculation agent;
- any event that disrupts or impairs, as determined by the calculation agent, the ability of market participants to (i) effect transactions in, or obtain market values for, the commodity in its primary market, or (ii) effect transactions in, or obtain market values for, futures or options contracts relating the commodity in its primary market;
- the closure on any day of the primary market for that commodity on a scheduled trading day prior to the scheduled weekday closing time of that market (without regard to after hours or any other trading outside of the regular trading session hours) unless such earlier closing time is announced by the primary market at least one hour prior to the earlier of (i) the actual closing time for the regular trading session on such primary market on such scheduled trading day for such primary market and (ii) the submission deadline for orders to be entered into the relevant exchange system for execution at the close of trading on such scheduled trading day for such primary market;
- any scheduled trading day on which (i) the primary market for that commodity or (ii) the exchanges or quotation systems, if any, on which futures or options contracts on that commodity are traded, fails to open for trading during its regular trading session; or
- any other event, if the calculation agent determines that the event interferes with our ability or the ability of any of our affiliates to unwind all or a portion of a hedge with respect to the notes that we or our affiliates have effected or may effect as described below under "Use of Proceeds and Hedging" in this prospectus supplement.

and, in any of these events, the calculation agent determines that the event was material.

The following events will not be market disruption events:

- a limitation on the hours or numbers of days of trading, but only if the limitation results from an announced change in the regular business hours of the relevant market; or
- a decision to permanently discontinue trading in the futures or options contracts relating to the commodity.

For this purpose, an "absence of trading" in the primary market on which futures or options contracts related to the commodity are traded will not include any time when that market is itself closed for trading under ordinary circumstances.

In contrast, a suspension or limitation of trading in a commodity, or futures or options contracts related to the commodity, if available, in their primary markets, by reason of any of:

- a price change exceeding limits set by that market,
- an imbalance of orders, or
- a disparity in bid and ask quotes,

will constitute a suspension or material limitation of trading.

If the calculation agent determines that a market disruption event occurs or is continuing on any valuation date, the valuation date will be the first following business day on which the calculation agent determines that a market disruption event does not occur and is not continuing. In no event, however, will the valuation date be postponed by more than five business days. If the calculation agent determines that a market disruption event occurs or is continuing on the fifth business day, the calculation agent will make an estimate of the settlement price for the commodity that would have prevailed on that fifth business day in the absence of the market disruption event.

Table of Contents

If the commodity is a basket component and the calculation agent determines that a market disruption event occurs or is continuing with respect to a commodity on any basket valuation date, the respective date will be postponed as described under "Reference Assets – Baskets – Market Disruption Events".

Discontinuation of Trading; Alteration of Method of Calculation

If the relevant exchange discontinues trading in any commodity, the calculation agent may replace the commodity with another commodity, whose settlement price is quoted on that exchange or any other exchange, that the calculation agent determines to be comparable to the discontinued commodity (a "successor commodity").

If the relevant exchange discontinues trading in the commodity comprising the reference asset prior to, and the discontinuance is continuing on, any valuation date and the calculation agent determines that no successor commodity is available at that time, then the calculation agent will determine the settlement price for that date.

Notwithstanding these alternative arrangements, discontinuance of trading on the applicable exchange in any commodity may adversely affect the market value of the notes.

If at any time (i) the method of calculating the official U.S. dollar cash buyer settlement price of a commodity is changed in a material respect by the applicable exchange or any other relevant exchange, (ii) there is a material change in the composition or constitution of a commodity or (iii) if the reporting thereof is in any other way modified so that the settlement price does not, in the opinion of the calculation agent, fairly represent the settlement price of the commodity, the calculation agent shall, at the close of business in New York City on each business day on which the settlement price is to be determined, make those calculations and adjustments as, in the judgment of the calculation agent, may be necessary in order to arrive at a settlement price for the commodity comparable to such commodity or such successor commodity, as the case may be, as if those changes or modifications had not been made, and calculate the amount of interest, payment at maturity and other amounts payable on the note (including the individual inputs thereof) with reference to such commodity or such successor commodity, as adjusted. In that event, the calculation agent will provide written notice to the trustee of these calculations and adjustments, and the trustee will furnish written notice thereof, to the extent the trustee is required to under the senior debt indenture, to each noteholder, or in the case of global notes, the depositary, as holder of the global notes.

Currency Exchange Rates

The principal, interest or any other amounts payable on the notes may be based on a currency exchange rate, including level movements in or other events relating to the currency exchange rates. If a reference asset is comprised of more than one currency exchange rate or a currency exchange rate and at least one other type of asset, the currency exchange rate is a "basket component".

To the extent that amounts payable on the notes are based on a reference asset comprised of one or more of the currency exchange rates below, the level with respect to that exchange rate on any day will equal the currency exchange rate as determined by the calculation agent by reference to the mechanics specified below:

(a) where the currency exchange rate is ARS, the Argentine Peso/U.S. Dollar official fixing rate, expressed as the amount of Argentine Pesos per one U.S. Dollar for settlement on the same day (or, if that day is not a business day in New York, for settlement on the first succeeding day that is a business day in both Buenos Aires and New York) which appears on the Reuters screen BNAR page at the close of business in Buenos Aires on the relevant valuation date;

(b) where the currency exchange rate is AUD, U.S. Dollar/Australian Dollar official fixing rate, expressed as the amount of U.S. Dollars per one Australian Dollar, for settlement in two business days reported by the Federal Reserve Bank of New York which appears on Reuters screen 1FEE to the right of the caption "AUD" at approximately 12.00 p.m., New York time, on the relevant valuation date;

Table of Contents

(c) where the currency exchange rate is BRL, the Brazilian Real/U.S. Dollar offered rate for U.S. Dollars, expressed as the amount of Brazilian Reals per one U.S. Dollar, for settlement in two business days reported by the Banco Central do Brasil on SISBACEN Data System under transaction code PTAX-800 ("Consulta de Cambio" or exchange rate Inquiry), Option 5 ("Cotacoes para Contabilidade" or Rates for Accounting Purposes), which appears on Reuters screen "BRFR" page under the caption "Dolar PTAX" at approximately 6:30 pm Sao Paolo time on the relevant valuation date;

(d) where the currency exchange rate is CAD, the Canadian Dollar/U.S. Dollar official fixing rate, expressed as the amount of Canadian Dollars per one U.S. Dollar, for settlement in one business day reported by the Federal Reserve Bank of New York which appears on Reuters screen 1FED to the right of the caption "CAD" at approximately 10:00 a.m. New York time, on the relevant valuation date;

(e) where the currency exchange rate is CLP, the Chilean Peso/U.S. Dollar observado rate, expressed as the amount of Chilean Pesos per one U.S. Dollar, for settlement on the same day (or, if that day is not a business day in New York, for settlement on the first succeeding day that is a business day in both Santiago and New York) reported by the Banco Central de Chile which appears on the Reuters screen "BCCH" page under the caption "OBSERVADO" at 10:00 a.m., Santiago time, on the first business day following the relevant valuation date;

(f) where the currency exchange rate is CNY, the Chinese Yuan/U.S. Dollar official fixing rate, expressed as the amount of Chinese Yuan per one U.S. Dollar, for settlement in two business days reported by the Federal Reserve Bank of New York which appears on Reuters screen 1FEE to the right of the caption "CNY" at approximately 12.00 p.m. New York time, on the relevant valuation date;

(g) where the currency exchange rate is CZK, the Czech Koruna/Euro fixing rate, expressed as the amount of Czech Koruna per one Euro which appears on Reuters screen ECB37 to the right of the caption "CZK" at approximately 2:15 p.m., Central European time, on the relevant valuation date;

(h) where the currency exchange rate is DKK, the Danish Krone/Euro fixing rate, expressed as the amount of Danish Krone per one Euro which appears on Reuters screen ECB37 to the right of the caption "DKK" at approximately 2:15 p.m., Central European time, on the relevant valuation date;

(i) where the currency exchange rate is COP, the Colombian Peso/U.S. Dollar official fixing rate, expressed as the amount of Colombian Pesos per one U.S. Dollar, for settlement on the same day (unless that day is not a business day in New York, then for settlement on the first succeeding day that is a business day in Bogota and New York) reported by the Colombian Banking Superintendency as the "TASA Representative del Mercado" as of 12:00 noon, Bogota time, on the first business day following the relevant valuation date;

(j) where the currency exchange rate is ECS, the Ecuadorian Sucre/U.S. Dollar official fixing rate, expressed as the amount of Ecuadorian Sucres per one U.S. Dollar, for settlement in one business day (where that day is a business day in Guayaquil and New York) which appears on the Reuters screen "DNRP" page at 12:00 noon, Guayaquil time, on the relevant valuation date;

(k) where the currency exchange rate is EUR, one divided by the U.S. Dollar/Euro official fixing rate, expressed as the amount of U.S. Dollars per one Euro, for settlement in two business days reported by the Federal Reserve Bank of New York which appears on Reuters screen 1FED to the right of the caption "EUR" at approximately 10:00 a.m. New York time, on the relevant valuation date;

(l) where the currency exchange rate is GBP, one divided by the U.S. Dollar/Sterling official fixing rate, expressed as the amount of U.S. Dollars per one Pound Sterling, for settlement in two business days reported by the Federal Reserve Bank of New York which appears on Reuters screen 1FED to the right of the caption "GBP" at approximately 10:00 a.m. New York time, on the relevant valuation date;

(m) where the currency exchange rate is HKD, the Hong Kong Dollar/U.S. Dollar official fixing rate, expressed as the amount of Hong Kong

Table of Contents

Dollars per one U.S. Dollar, for settlement in two business days reported by the Federal Reserve Bank of New York which appears on Reuters screen 1FEE to the right of the caption “HKD” at approximately 12:00 p.m. New York time, on the relevant valuation date;

(n) where the currency exchange rate is HUF, the Hungarian Forint/Euro fixing rate, expressed as the amount of Hungarian Forint per one Euro which appears on Reuters screen ECB37 to the right of the caption “HUF” at approximately 2:15 p.m., Central European time, on the relevant valuation date;

(o) where the currency exchange rate is IDR, the Indonesian Rupiah/U.S. Dollar spot rate at 11:00 a.m., Singapore time, expressed as the amount of Indonesian Rupiah per one U.S. Dollar, for settlement in two business days, reported by the Association of Banks in Singapore which appears on the Reuters page “ABSIRFIX01” to the right of the caption “Spot” under the column “IDR” at approximately 11:30 a.m., Singapore time, on the relevant valuation date;

(p) where the currency exchange rate is ILS, the Israeli Shekel/U.S. Dollar official fixing rate, expressed as the amount of Israeli Shekels per one U.S. Dollar, for settlement in two business days which appears on the Reuters “BOIJ” page as of 1:00 p.m., Tel Aviv time, on the relevant valuation date;

(q) where the currency exchange rate is INR, the spot rate for the relevant valuation date will be the Indian Rupee/U.S. Dollar reference rate, expressed as the amount of Indian Rupee per one U.S. Dollar, for settlement in two business days reported by the Reserve Bank of India which appears on the Reuters screen “RBIB” page at approximately 12:30 p.m., Mumbai time, or as soon thereafter as practicable, on the relevant valuation date;

(r) where the currency exchange rate is ISK, the Icelandic Krona/Euro fixing rate, expressed as the amount of Icelandic Krona per one Euro which appears on Reuters screen ECB37 to the right of the caption “ISK” at approximately 2:15 p.m., Central European time, on the relevant valuation date;

(s) where the currency exchange rate is JPY, the Japanese Yen/U.S. Dollar official fixing rate, expressed as the amount of Japanese Yen per one U.S. Dollar, for settlement in two business days reported by the Federal Reserve Bank of New York which appears on Reuters screen “1FED” to the right of the caption “JPY” at approximately 10:00 a.m. New York time, on the relevant valuation date;

(t) where the currency exchange rate is KRW, the Korean Won/U.S. Dollar market average rate (official fixing), expressed as the amount of Korean Won per one U.S. Dollar, for settlement in two business days reported by the Korea Financial Telecommunications and Clearing Corporation which appears on the Reuters screen “KFTC18” page under the heading “KRW” and in the row “USD” between the hours of 8:00 a.m. and 9:00 a.m., Seoul time, on the first business day following the relevant valuation date;

(u) where the currency exchange rate is LBP, the Lebanese Pound/U.S. Dollar official fixing rate, expressed as the amount of Lebanese Pounds per one U.S. Dollar, for settlement in two business days which appears on the Reuters screen “BDLX” page as of 12:00 noon, Beirut time, on the relevant valuation date;

(v) where the currency exchange rate is MAD, the Moroccan Dirham/U.S. Dollar official fixing rate, expressed as the amount of Moroccan Dirham per one U.S. Dollar, for settlement in two business days reported by the Central Bank of Morocco as of 1:00 p.m., Rabat time, on the relevant valuation date;

(w) where the currency exchange rate is MXP, the Mexican Pesos/U.S. Dollar official fixing rate, expressed as the amount of Mexican Pesos per one U.S. Dollar, for settlement in two business days reported by Banco de Mexico which appears on the Reuters screen “BNMX” page opposite the caption “Fix” at the close of business in Mexico City on the relevant valuation date;

(x) where the currency exchange rate is MYR, the Malaysian Ringgit/U.S. Dollar spot rate at 11:00 a.m., Singapore time, expressed as the amount of Malaysian Ringgit per one U.S. Dollar, for settlement in two business days, reported by the Association of Banks in Singapore, which appears on the Reuters page “ABSIRFIX01” to the right of the caption “Spot” under the column “MYR” at approximately 11:30 a.m., Singapore time, on the relevant valuation date;

Table of Contents

(y) where the currency exchange rate is NOK, the Norwegian Krone/Euro fixing rate, expressed as the amount of Norwegian Krone per one Euro which appears on Reuters screen “ECB37” to the right of the caption “NOK” at approximately 2:15 p.m., Central European time, on the relevant valuation date;

(z) where the currency exchange rate is NZD, the New Zealand Dollar/U.S. Dollar official fixing rate, expressed as the amount of New Zealand Dollars per one U.S. Dollar, for settlement in two business days reported by the Federal Reserve Bank of New York which appears on Reuters screen “1FEE” to the right of the caption “NZD” at approximately 12.00 p.m., New York time, on the relevant valuation date.

(aa) where the currency exchange rate is PEN, the Peruvian Sol/U.S. Dollar fixing rate (mid market last), expressed as the amount of Peruvian Sols per one U.S. Dollar, for settlement on that same day which appears on the Reuters screen “PDSB” page opposite the caption “PEN=“ as of 12:00 noon, Lima time, on the relevant valuation date;

(bb) where the currency exchange rate is PHP, the Philippine Peso/U.S. Dollar tom rate (mid market), expressed as the amount of Philippine Pesos per one U.S. Dollar, for settlement in one business day which appears on the Reuters screen “PHPESO” page at approximately 11:00 a.m., Manila time, on the relevant valuation date;

(cc) where the currency exchange rate is PLN, the Polish Zloty/Euro fixing rate, expressed as the amount of Polish Zloty per one Euro which appears on Reuters screen ECB37 to the right of the caption “PLN” at approximately 2:15 p.m., Central European time, on the relevant valuation date;

(dd) where the currency exchange rate is PKR, the Pakistan Rupee/U.S. Dollar reference rate, expressed as the amount of Pakistan Rupee per one U.S. Dollar, for settlement in two business days which appears on Reuters screen “SBPK” page at the specified time, if any, on the relevant valuation date;

(ee) where the currency exchange rate is PLZ, the Polish Zloty/U.S. Dollar fixing rate, expressed as the amount of Polish Zloty per one U.S. Dollar, for settlement in two business days reported by the National Bank of Poland which appears on the Reuters screen “NBPR” page at the specified time, if any, on the relevant valuation date;

(ff) where the currency exchange rate is RUB, the Russian Ruble/U.S. Dollar official fixing rate, expressed as the amount of Russian Rubles per one U.S. Dollar, for settlement on the same day reported by the Chicago Mercantile Exchange pursuant to its arrangement with the Emerging Markets Traders Association which appears on the Reuters screen “EMTA” page as of 11:00 a.m., Moscow time, on the relevant valuation date;

(gg) where the currency exchange rate is SEK, the Swedish Krona/Euro fixing rate, expressed as the amount of Swedish Krona per one Euro which appears on Reuters screen “ECB37” to the right of the caption “SEK” at approximately 2:15 p.m., Central European time, on the relevant valuation date;

(hh) where the currency exchange rate is SGD, the Singapore Dollar/U.S. Dollar spot rate at 11:00 a.m., Singapore time, expressed as the amount of Singapore Dollar per one U.S. Dollar, for settlement in two business days, reported by the Association of Banks in Singapore which appears on the Reuters page “ABSIRFIX01” to the right of the caption “Spot” under the column “SGD” at approximately 11:30 a.m., Singapore time, on the relevant valuation date;

(ii) where the currency exchange rate is SKK, the Slovak Koruna/U.S. Dollar official fixing rate, expressed as the amount of Slovak Koruna per one U.S. Dollar, for settlement in two business days reported by the National Bank of Slovakia which appears on the Reuters screen “NBSB” page as of 11:40 a.m., Bratislava time, on the relevant valuation date;

(jj) where the currency exchange rate is THB, the Thai Baht/U.S. Dollar spot rate at 11:00 a.m., Singapore time, expressed as the amount of Thai Baht per one U.S. Dollar, for settlement in two Business Days, reported by the Association of Banks in Singapore which appears on the Reuters page “ABSIRFIX01” to the right of the caption “Spot” under the column “THB” at approximately 11:30 a.m., Singapore time, on the relevant valuation date;

Table of Contents

(kk) where the currency exchange rate is TRY, the Turkish Lira/Euro fixing rate, expressed as the amount of Turkish Lira per one Euro which appears on Reuters screen “ECB37” to the right of the caption “TRY” at approximately 2:15 p.m., Central European time, on the relevant valuation date;

(ll) where the currency exchange rate is TWD, the Taiwanese Dollar/U.S. Dollar specified rate, expressed as the amount of Taiwanese Dollars per one U.S. Dollar, for settlement in two business days which appears on the Reuters screen “TFEMA” page as of 11:00 a.m., Taipei time, on the relevant valuation date;

(mm) where the currency exchange rate is UAH, the Ukrainian Hryvnia/U.S. Dollar interbank rate, expressed as the amount of Ukrainian Hryvnia per one U.S. Dollar, for settlement on the same day reported by the Ukraine Interbank Currency Exchange which appears on the Reuters screen “UICE1” page at the specified time, if any, on the relevant valuation date;

(nn) where the currency exchange rate is USD, the U.S. Dollar/Euro fixing rate, expressed as the amount of U.S. Dollar per one Euro which appears on Reuters screen ECB37 to the right of the caption “USD” at approximately 2:15 p.m., Central European time, on the relevant valuation date;

(oo) where the currency exchange rate is VER, the Venezuelan Bolivar/U.S. Dollar tipo de câmbio referencial rate, expressed as the amount of Venezuelan Bolivar per one U.S. Dollar, for settlement in two business days (where these days are business days in both Caracas and New York) reported by the Banco Central de Venezuela which appears on the Reuters screen “VBCV” page at approximately 5:00 p.m., Caracas time, on the relevant valuation date; and

(pp) where the currency exchange rate is ZAR, the South African Rand/Euro fixing rate, expressed as the amount of South African Rand per one Euro which appears on Reuters screen “ECB37” to the right of the caption “ZAR” at approximately 2:15 p.m., Central European time, on the relevant valuation date.

The screen or time of observation indicated in relation to any currency exchange rate above shall be deemed to refer to that screen or time of observation as modified or amended from time to time, or to any substitute screen thereto.

To the extent that amounts payable on the notes are based on a reference asset comprised of one or more currency exchange rates not described above, the closing level of that currency exchange rate on any day will equal the currency exchange rate as determined by the calculation agent by reference to the mechanics, the Reuters screen, Bloomberg page or other pricing source and the time specified in the applicable pricing supplement.

Market Disruption Events Relating to Notes with the Reference Asset Comprised of a Currency Exchange Rate or Currency Exchange Rates

Any of the following will be a market disruption event where the reference asset is comprised of a currency exchange rate or exchanges rates:

- any event or any condition (including without limitation any event or condition that occurs as a result of the enactment, promulgation, execution, ratification, interpretation or application of, or any change in or amendment to, any law, rule or regulation by any applicable governmental authority) that results in an illiquid market for currency transactions or that generally makes it impossible, illegal or impracticable for market participants, or hinders their abilities, (a) to convert from one foreign currency to another through customary commercial channels, (b) to effect currency transactions or (c) to obtain the currency exchange rate by reference to the applicable price source;
- (i) the declaration of a banking moratorium or (ii) the suspension of payments by banks, in either case, in the country of any currency used to determine the applicable currency exchange rate or (iii) the declaration of capital and/or currency controls (including without limitation any restriction placed on assets in or transactions through any account through which a non-resident of the country of any currency used to determine the applicable currency exchange rate may hold assets or transfer monies outside the country of that currency, and any restriction on the transfer of funds, securities or other assets of market participants from or within or outside of the country of any currency used to determine the applicable currency exchange rate); or

Table of Contents

- any other event, if the calculation agent determines that the event interferes with our ability or the ability of any of our affiliates to unwind all or a portion of a hedge with respect to the notes that we or our affiliates have effected or may effect as described below under "Use of Proceeds and Hedging" in this prospectus supplement;
- and, in any of these events, the calculation agent determines that the event was material.

If the calculation agent determines that a market disruption event occurs or is continuing on any valuation date, the valuation date will be the first following business day on which the calculation agent determines that a market disruption event does not occur and is not continuing. In no event, however, will the valuation date be postponed by more than five business days. If the calculation agent determines that a market disruption event occurs or is continuing on the fifth business day, the calculation agent will make an estimate of the currency exchange rate for the currency that would have prevailed on that fifth business day in the absence of the market disruption event.

If the currency exchange rate is a basket component and the calculation agent determines that a market disruption event occurs or is continuing with respect to a currency exchange rate on any basket valuation date, the respective date will be postponed as described under "Reference Assets—Baskets—Market Disruption Events".

Adjustments Relating to Notes with the Reference Asset Comprised of a Currency Exchange Rate or Currency Exchange Rates

If the calculation agent determines that (i) any currency exchange rate has been removed from circulation or otherwise discontinued and (ii) banks dealing in foreign exchange and foreign currency deposits in the underlying currency commence trading a successor or substitute currency substantially similar to the foreign currency that the calculation agent determines is comparable to the discontinued currency (that currency being referred to herein as a "successor currency"), then the level for the currency will be determined by reference to the value of the successor currency at the time determined by the calculation agent on the markets for the successor currency on the relevant valuation date.

If the calculation agent determines that any successor currency shall be utilized for purposes of calculating the level of the currency comprising the currency exchange rate, or making any other determinations as of or after that time, the calculation agent will make those calculations and adjustments as, in judgment of the calculation agent, may be necessary in order to arrive at a value of a currency exchange rate for a currency comparable to the underlying currency, as if those changes or modifications had not been made, and shall calculate the payment at maturity (including the individual inputs thereof) and the final level with reference to that currency or the successor currency, as adjusted. In this event, the calculation agent will provide written notice to the trustee thereof, and the trustee will furnish written notice thereof, to the extent the trustee is required to under the senior debt indenture, to each noteholder, or in the case of global notes, the depositary, as holder of the global notes.

Notwithstanding these alternative arrangements, discontinuance of the publication of the level of any currency comprising the currency exchange rate may adversely affect the value of, and trading in, the notes.

If at any time the method of calculating the level of a currency or a successor currency, or the value thereof, is changed in a material respect, or is in any other way modified so that the conventional market quotation does not, in the opinion of the calculation agent, fairly represent the value of that currency or successor currency had those changes or modifications not been made, then, for purposes of calculating any level, the payment at maturity or making any other determinations as of or after that time, the calculation agent will make those calculations and adjustments as the calculation agent determines may be necessary in order to arrive at a value for that currency comparable to the underlying currency comprising the currency exchange rate or that successor currency, as

Table of Contents

the case may be, as if those changes or modifications have not been made, and calculate the amount of interest, payment at maturity and other amounts payable on the note (including the individual inputs thereof) with reference to the currency or the successor currency, as adjusted. In such event, the calculation agent will provide written notice to the trustee thereof, and the trustee will furnish written notice thereof, to the extent the trustee is required to under the senior debt indenture, to each noteholder, or in the case of global notes, the depositary, as holder of the global notes.

Baskets

The principal, interest or any other amounts payable on the notes may be based on a basket of multiple instruments or measures, including but not limited to equity securities, commodities, indices, foreign currencies, interest rates and/or any combination thereof.

To the extent that a component of a basket is comprised of an asset type herein described, see the applicable section under the heading "Reference Assets" for further information that may affect that component of the basket, and therefore the reference asset of your notes.

Market Disruption Events for Notes with the Reference Asset Comprised of a Basket of Multiple Indices, Equity Securities, Foreign Currencies, Interest Rates, Commodities, Any Other Assets or Any Combination Thereof

With respect to each basket component, a market disruption event will be described in the section of this prospectus supplement applicable to that basket component.

For example, the "Reference Assets – Securities or 'Linked Shares'" section describes the circumstances under which the calculation agent may determine that there is a market disruption event with respect to a basket component that consists of an equity security.

The basket valuation date will be the date stated in the applicable pricing supplement, unless the calculation agent determines that a market disruption event occurs or is continuing on that respective day.

If no market disruption event exists with respect to a basket component on a basket valuation date, such basket component's level, value or price shall be determined on the scheduled basket valuation date. To the extent that a market disruption event exists with respect to a component on the basket valuation date, the price, value or level of that disrupted basket component shall be determined in accordance with the procedures set forth above for the specific reference asset type of the basket component.

Adjustments Relating to Notes with the Reference Asset Comprised of a Basket

If the calculation agent substitutes a successor index, successor currency or successor commodity, as the case may be, or otherwise affects or modifies the reference asset, the calculation agent will make those calculations and adjustments as, in judgment of the calculation agent, may be necessary in order to arrive at a basket comparable to the original basket (including without limitation changing the percentage weights of the basket components), as if those changes or modifications had not been made, and shall calculate the amount of interest, payment at maturity and other amounts payable on the note (including the individual inputs thereof) with reference to that basket or the successor basket (as described below), as adjusted. In this event, the calculation agent will provide written notice to the trustee thereof, and the trustee will furnish written notice thereof, to the extent the trustee is required to under the senior debt indenture, to each noteholder, or in the case of global notes, the depositary, as holder of the global notes.

In the event of the adjustment described above, the newly composed basket is referred to herein as the "successor basket" and will be used as a substitute for the original basket for all purposes.

If the calculation agent determines that the available successors as described above do not fairly represent the value of the original basket component or basket, as the case may be, then the calculation agent will determine the level, value or price of the basket component or the basket level for any basket valuation date as described under "Reference Assets—Indices—Adjustments Relating to Notes with the Reference Asset Comprised of an Index" with respect to indices comprising the basket component, "Reference Assets—Commodities—Discontinuation of Trading; Alteration of Method

Table of Contents

of Calculation" with respect to commodities comprising the basket component and "Reference Assets—Currency Exchange Rates—Adjustments Relating to Notes with the Reference Asset Comprised of a Currency Exchange Rate or Currency Exchange Rates" with respect to currency exchange rates comprising the basket component.

Notwithstanding these alternative arrangements, discontinuance of trading on the applicable exchanges or markets in any basket component may adversely affect the market value of the notes.

Reference Asset Information Provider

The notes have not been passed on by the information provider of the reference asset as to their legality or suitability. The notes are not issued, endorsed, sponsored or promoted by and are not financial or legal obligations of the information provider of the reference asset. The trademarks, service marks or registered trademarks of the information provider of the reference asset are the property of their respective owners. The information provider of the reference asset makes no warranties and bears no liabilities with respect to the notes or to the administration or operation of the notes.

Applicable historical data on the reference asset will be provided in the applicable pricing supplement.

The possible "information providers" of the reference assets are Bloomberg screen, Reuters screen, Telerate or any other information provider as specified in the applicable pricing supplement.

Bloomberg screen

"Bloomberg screen" means, when used in connection with any designated pages, the display page so designated on the Bloomberg service (or any other page as may replace that page on that service, or any other service as may be nominated as the information vendor).

Reuters screen

"Reuters screen" means, when used in connection with any designated page, the display page so designated on the Reuters Money 3000 Service (or any other page as may replace that page on that service for the purpose of displaying rates or prices).

Telerate

"Telerate" means, when used in connection with any designated page, the display page so designated on the Moneyline Telerate Service (or any other page as may replace that page on that service, or any other service as may be nominated as the information vendor).

EMPLOYEE RETIREMENT INCOME SECURITY ACT

Each fiduciary of a pension, profit-sharing or other employee benefit plan (a "plan") subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), should consider the fiduciary standards of ERISA in the context of the plan's particular circumstances before authorizing an investment in the notes. Accordingly, among other factors, the fiduciary should consider whether the investment would satisfy the prudence and diversification requirements of ERISA and would be consistent with the documents and instruments governing the plan, and whether the investment would involve a prohibited transaction under Section 406 of ERISA and Section 4975 of the Internal Revenue Code of 1986, as amended (the "Code").

Section 406 of ERISA and Section 4975 of the Code prohibit plans, as well as individual retirement accounts and Keogh plans subject only to Section 4975 of the Code (also "plans") from engaging in certain transactions involving "plan assets" with persons who are "parties in interest" under ERISA or "disqualified persons" under the Code ("parties in interest") with respect to the plan or account. A violation of these prohibited transaction rules may result in civil penalties or other liabilities under ERISA and/or an excise tax under Section 4975 of the Code for those persons, unless relief is available under an applicable statutory or administrative exemption. Some employee benefit plans and arrangements including those that are governmental plans (as defined in section 3(32) of ERISA), certain church plans (as defined in Section 3(33) of ERISA) and foreign plans (as described in Section 4(b)(4) of ERISA) ("non-ERISA arrangements") are not subject to the requirements of ERISA or Section 4975 of the Code but may be subject to similar provisions under applicable federal, state, local, foreign or other regulations, rules or laws.

Table of Contents

The acquisition of the notes by a plan with respect to which Barclays Bank PLC, Barclays Capital Inc. or certain of our affiliates is or becomes a party in interest may constitute or result in prohibited transaction under ERISA or Section 4975 of the Code, unless those notes are acquired pursuant to and in accordance with an applicable statutory or administrative exemption.

The U.S. Department of Labor has issued five prohibited transaction class exemptions, or "PTCEs", that may provide exemptive relief if required for direct or indirect prohibited transactions that may arise from the purchase or holding of the notes. These exemptions are:

(a) PTCE 84-14, an exemption for certain transactions determined or effected by independent qualified professional asset managers;

(b) PTCE 90-1, an exemption for certain transactions involving insurance company pooled separate accounts;

(c) PTCE 91-38, an exemption for certain transactions involving bank collective investment funds;

(d) PTCE 95-60, an exemption for transactions involving certain insurance company general accounts; and

(e) PTCE 96-23, an exemption for plan asset transactions managed by in-house asset managers.

It should be noted that the recently enacted Pension Protection Act of 2006 contains a new statutory exemption from the prohibited transaction provisions of Section 406 of ERISA and Section 4975 of the Code for transactions involving certain parties in interest or disqualified persons who are such merely because they are a service provider to a plan subject to ERISA and/or Section 4975 of the Code, or because they are related to a service provider. Generally, the new exemption would be applicable if the party to the transaction with the plan is a party in interest or a disqualified person to the plan but is not (i) an employer, (ii) a fiduciary who has or exercises any discretionary authority or control with respect to the investment of the plan assets involved in the transaction, (iii) a fiduciary who renders investment advice (within the meaning of ERISA and Section 4975 of the Code) with respect to those assets, or (iv) an affiliate of (i), (ii) or (iii). Any fiduciary relying on this new statutory exemption (Section 408(b)(17) of ERISA and Section 4975(d)(20) of the Code) and purchasing securities on behalf of a plan will be deemed to have made a determination that (x) the plan is paying no more than, and is receiving no less than, adequate consideration in connection with the transaction and (y) neither Barclays Bank PLC, Barclays Capital Inc. nor any of their affiliates directly or indirectly exercises any discretionary authority or control or renders investment advice (as defined above) with respect to the assets of the plan which the fiduciary is using to purchase notes, both of which are necessary preconditions to utilizing this new exemption. Any person proposing to acquire any securities on behalf of a plan should consult with counsel regarding the application of the new exemption.

The notes may not be purchased or held by (1) any plan, (2) any entity whose underlying assets include "plan assets" by reason of any plan's investment in the entity (a "plan asset entity") pursuant to Department of Labor Regulation 29 CFR 2510.3-101, as modified by Section 3(42) of ERISA, or otherwise or (3) any person investing "plan assets" of any plan, unless in each case the purchaser or holder is eligible for the exemptive relief available under one or more of the PTCEs listed above or another applicable statutory or similar exemption. Any purchaser or holder of the notes or any interest in the notes will be deemed to have represented by its purchase and holding of the notes that it either (1) is not a plan or a plan asset entity and is not purchasing those notes on behalf of or with "plan assets" of any plan or plan asset entity or (2) with respect to the purchase or holding, is eligible for the exemptive relief available under any of the PTCEs listed above or another applicable statutory or administrative exemption. Any purchaser or holder of the notes that is or is using the assets of, directly or indirectly, an employee benefit plan not subject to ERISA or Section 4975 of the Code, such as a government plan or a foreign plan, will be deemed to have represented, by its purchase and holding of the notes, that the purchase, holding and subsequent disposition of the notes and the transactions contemplated

Table of Contents

hereby do not constitute non-exempt violations of any applicable federal, state, local or foreign laws, rules, regulations or other restrictions, regardless of whether those restrictions are materially similar to Section 406 of ERISA and/or Section 4975 of the Code.

Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt prohibited transactions, it is important that fiduciaries or other persons considering purchasing the notes on behalf of or with "plan assets" of any plan, plan asset entity or non-ERISA arrangement consult with their counsel regarding the availability of exemptive relief under any of the PTCEs listed above or any other applicable exemption, or the potential consequences of any purchase or holding under similar laws, as applicable.

The sale of any note to a plan or a non-ERISA arrangement is in no respect a representation by Barclays Bank PLC, Barclays Capital Inc. or any of their affiliates that the investment meets all relevant legal requirements with respect to investments by plans or non-ERISA arrangements generally or any particular plan or non-ERISA arrangement, or that the investment is appropriate for a plan or a non-ERISA arrangement generally or any particular plan or non-ERISA arrangement.

Each plan purchaser and holder of notes, by its purchasing and holding of the notes, will be deemed to have acknowledged, represented to and agreed with Barclays Bank PLC, Barclays Capital Inc. or any of their affiliates that the plan is purchasing and holding the notes pursuant to one of the PTCEs listed above, the "service provider" exemption (Section 408(b)(17) of ERISA and Section 4975(d)(20) of the Code) or another statutory or administrative exemption from the prohibited transaction provisions of Section 406 of ERISA and/or Section 4975 of the Code.

If you are an insurance company or the fiduciary of a pension plan or an employee benefit plan, and propose to invest in the notes, you should consult your legal counsel.

PLAN OF DISTRIBUTION

Initial Offering and Sale of Notes

Distribution Agreement. We plan to sell all or part of the medium-term notes under a distribution agreement with Barclays Capital Inc., as agent, relating to our medium-term notes. Pursuant to the distribution agreement, the agent has agreed to use its reasonable efforts to solicit and receive offers to purchase the notes from us upon the terms and conditions set forth in the applicable pricing supplement. We filed the form of distribution agreement with the SEC under cover of Form 6-K on September 20, 2004 (File No. 001-10257). We would have the right to accept offers to purchase notes and may reject any proposed purchase of the notes. The agent may also reject any offer to purchase notes. We would pay the agent a commission on any notes sold through the agent. In compliance with the guidelines of the National Association of Securities Dealers, Inc., the maximum discount or commission to be received by any NASD member or independent broker-dealer may not exceed 8% of the aggregate amount of the notes offered pursuant to the applicable pricing supplement.

We may also sell notes to the agent as principal for its own account in a firm commitment underwriting. In that case, the agent will purchase the notes at a price equal to the issue price specified in the applicable pricing supplement, less a discount. The discount will equal the applicable commission on an agency sale of notes with the same stated maturity.

The agent may resell any notes it purchases as principal to other brokers or dealers at a discount, which may include all or part of the discount the agent received from us. If all the notes are not sold at the initial offering price, the agents may change the offering price and other selling terms.

We may appoint agents under the distribution agreement other than or in addition to Barclays Capital Inc. Any of these agents will enter into the distribution agreement referred to above, and the applicable pricing supplement will name any of these agents involved in the offering and sale of the notes and any commission that we will pay to them. Agents through whom we sell notes may enter into arrangements with other institutions with respect to the distribution of the

Table of Contents

notes, and those institutions may share in the commissions, discounts or other compensation received by our agents, may be compensated separately and may also receive commissions from purchasers for whom they may act as agents. The other agents may be our affiliates or customers and may engage in transactions with and perform services for us in the ordinary course of business. Barclays Capital Inc. may resell notes to or through another of our affiliates, as selling agent.

Other Arrangements. In addition to sales under the distribution agreement referred to above, we may also sell all or part of the notes from time to time, on terms determined at that time, through underwriters, dealers and/or agents, directly to purchasers or through a combination of any of these methods of sale. We describe these other arrangements in "Plan of Distribution" in the accompanying prospectus. We may also engage other firms to provide marketing or promotional services in connection with the distribution of the notes. We will describe any of these arrangements in the applicable pricing supplement.

Settlement. The applicable pricing supplement will specify when the notes will be delivered. Delivery of the notes may be made against payment after the third business day following the date of the applicable pricing supplement, or otherwise as specified by the applicable pricing supplement (for example, if delivery against payment is on the seventh business day, the settlement cycle will be referred to as "T+7"). Under Rule 15c6-1 under the U.S. Securities Exchange Act of 1934, trades in the secondary market generally are required to settle in three business days, unless the parties to the trade expressly agree otherwise. Accordingly, purchasers who wish to trade notes on the date of the applicable pricing supplement will be required, by virtue of the fact that the notes initially will settle, for example, in T+7, to specify an alternative settlement cycle at the time of any such trade to prevent a failed settlement and should consult their own advisor.

Market-Making Resales

This prospectus supplement may be used by Barclays Capital Inc. in connection with offers and sales of the notes in market-making transactions. In a market-making transaction, Barclays Capital Inc. may resell a note it acquires from other holders, after the original offering and sale of the note. Resales of this kind may occur in the open market or may be privately negotiated, at prevailing market prices at the time of resale or at related or negotiated prices. In these transactions, Barclays Capital Inc. may act as principal, or agent, including as agent for the counterparty in a transaction in which Barclays Capital Inc. acts as principal, or as agent for both counterparties in a transaction in which Barclays Capital Inc. does not act as principal. Barclays Capital Inc. may receive compensation in the form of discounts and commissions, including from both counterparties in some cases. Other affiliates of Barclays Bank PLC may also engage in transactions of this kind and may use this prospectus supplement for this purpose.

The aggregate initial offering price specified on the cover of the accompanying pricing supplement relates to the initial offering of the notes described in the pricing supplement. This amount does not include notes sold in market-making transactions. The latter includes notes to be issued after the date of this prospectus supplement, as well as notes previously issued.

Barclays Bank PLC may receive, directly or indirectly, all or a portion of the proceeds of any market-making transactions by Barclay's Capital Inc. and its other affiliates. Fees in connection with possible related swaps and other agreements may need to be described in the applicable pricing supplement depending on the circumstances.

Information about the trade and settlement dates, as well as the purchase price, for a market-making transaction will be provided to the purchaser in a separate confirmation of sale.

Unless we or an agent informs you in your confirmation of sale that your note is being purchased in its original offering and sale, you may assume that you are purchasing your note in a market-making transaction.

Matters Relating to Initial Offering and Market-Making Resales

Each issue of notes will be a new issue, and there will be no established trading market for any note prior to its original issue date. We do not intend to list any particular issue of notes unless specified in the applicable pricing

Table of Contents

supplement. We have been advised by Barclays Capital Inc. that it may make a market in the notes, and any underwriters to whom we sell notes for public offering or broker-dealers may also make a market in those notes. However, neither Barclays Capital Inc. nor any underwriter or broker-dealer that makes a market is obligated to do so, and any of them may stop doing so at any time without notice. We cannot give any assurance as to the liquidity of the trading market for the notes.

Unless otherwise indicated in the applicable pricing supplement or confirmation of sale, the purchase price of the notes will be required to be paid in immediately available funds in New York City.

In this prospectus supplement, the accompanying prospectus, and the applicable pricing supplement, the terms “this offering” means the initial offering of notes made in connection with their original issuance. This term does not refer to any subsequent resales of notes in market-making transactions.

USE OF PROCEEDS AND HEDGING

We will use the net proceeds we receive from the sale of the notes for the purposes we describe below. We or our affiliates may also use those proceeds in transactions intended to hedge our obligations under the notes as described below.

On or prior to the sale of the notes, we or our affiliates expect to enter into hedging transactions to hedge some or all of our anticipated exposure by, for example, taking or modifying positions in the reference assets and listed or over-the-counter options on the reference assets. From time to time, we or our affiliates may enter into additional hedging transactions or unwind those we have entered into.

In this regard, we or our affiliates may, throughout the life of the notes:

- acquire or dispose of long or short positions in listed or over-the-counter options, futures or other instruments linked to the reference asset,
- acquire or dispose of long or short positions in components of the reference assets,
- acquire or dispose of long or short positions in listed or over-the-counter options, futures or other instruments designed to track the performance of the reference assets or their components, or
- any other transaction or arrangement.

We or our affiliates may acquire a long or short position in securities similar to the notes from time to time and may, in our or their sole discretion, hold or resell those securities.

We or our affiliates may close out our or their hedge on or before the final valuation date. That step may involve sales or purchases of some or all of the components of the reference asset, or listed or over-the-counter options, futures or other instruments linked to the reference assets or their components.

The hedging activity discussed above may adversely affect the market value of the notes from time to time. See “Risk Factors” in this prospectus supplement for a discussion of these adverse effects.

CERTAIN U.S. FEDERAL INCOME TAX CONSIDERATIONS

The following discussion supersedes the discussion set forth in “Tax Considerations” in the accompanying prospectus. The following discussion summarizes certain of the material U.S. federal income tax consequences of the purchase, beneficial ownership, and disposition of the notes.

For purposes of this summary, a “U.S. holder” is a beneficial owner of a note that is:

- an individual who is a citizen or a resident of the United States, for federal income tax purposes;
- a corporation (or other entity that is treated as a corporation for federal tax purposes) that is created or organized in or under the laws of the United States or any State thereof (including the District of Columbia);
- an estate whose income is subject to federal income taxation regardless of its source; or
- a trust if a court within the United States is able to exercise primary supervision over its administration, and one or more United States persons (as defined for federal income tax purposes) have the authority to control all of its substantial decisions.

Table of Contents

For purposes of this summary, a "non-U.S. holder" is a beneficial owner of a note that is:

- a nonresident alien individual for federal income tax purposes;
- a foreign corporation for federal income tax purposes;
- an estate whose income is not subject to federal income tax on a net income basis; or
- a trust if no court within the United States is able to exercise primary jurisdiction over its administration or if United States persons (as defined for federal income tax purposes) do not have the authority to control all of its substantial decisions.

An individual may, subject to certain exceptions, be deemed to be a resident of the United States for federal income tax purposes by reason of being present in the United States for at least 31 days in the calendar year and for an aggregate of at least 183 days during a three year period ending in the current calendar year (counting for those purposes all of the days present in the current year, one third of the days present in the immediately preceding year, and one sixth of the days present in the second preceding year).

This summary is based on interpretations of the Code, regulations issued thereunder, and rulings and decisions currently in effect (or in some cases proposed), all of which are subject to change. Any of those changes may be applied retroactively and may adversely affect the federal income tax consequences described herein. This summary addresses only holders that purchase notes at initial issuance, and own notes as capital assets and not as part of a "straddle", "hedge", "synthetic security", or "conversion transaction" for federal income tax purposes or as part of some other integrated investment. This summary does not discuss all of the tax consequences that may be relevant to particular investors or to investors subject to special treatment under the federal income tax laws (such as banks, thrifts or other financial institutions; insurance companies; securities dealers or brokers, or traders in securities electing mark-to-market treatment; regulated investment companies or real estate investment trusts; small business investment companies; S corporations; investors that hold their notes through a partnership or other entity treated as a partnership for federal tax purposes; investors whose functional currency is not the U.S. dollar; certain former citizens or residents of the United States; persons subject to the alternative minimum tax; retirement plans or other tax-exempt entities, or persons holding the notes in tax-deferred or tax-advantaged accounts; or "controlled foreign corporations" or "passive foreign investment companies" for federal income tax purposes). This summary also does not address the tax consequences to shareholders, or other equity holders in, or beneficiaries of, a holder, or any state, local or foreign tax consequences of the purchase, ownership or disposition of the notes. Persons considering the purchase of notes should consult their own tax advisors concerning the application of federal income tax laws to their particular situations as well as any consequences of the purchase, beneficial ownership and disposition of notes arising under the laws of any other taxing jurisdiction.

The applicable pricing supplement may contain a further discussion of the special federal income tax consequences applicable to certain notes. The summary of the federal income tax considerations contained in the applicable pricing supplement supersedes the following summary to the extent it is inconsistent therewith.

PROSPECTIVE PURCHASERS OF NOTES SHOULD CONSULT THEIR TAX ADVISORS AS TO THE FEDERAL, STATE, LOCAL, AND OTHER TAX CONSEQUENCES TO THEM OF THE PURCHASE, OWNERSHIP AND DISPOSITION OF NOTES.

U.S. Federal Income Tax Treatment of the Notes as Indebtedness for U.S. Federal Income Tax Purposes

Unless otherwise indicated in the applicable pricing supplement and except as provided below under "—Certain Notes Treated as Forward Contracts or Executory Contracts" and "Certain Notes Treated as Put Options" we intend to treat the notes as indebtedness for federal income tax purposes, and the balance of this summary, except as provided below under "—Certain Notes Treated as Forward Contracts

Table of Contents

or Executory Contracts" and "Certain Notes Treated as Put Options" assumes that the notes are treated as indebtedness for federal income tax purposes. However, the treatment of a note as indebtedness for federal income tax purposes depends on a number of factors, and if the notes are not properly treated as indebtedness for federal income tax purposes, the federal income tax treatment of investors in notes may be different than that described below.

Payments of Interest

Unless otherwise indicated in the applicable pricing supplement, interest on a note will be taxable to a U.S. holder as ordinary interest income at the time it accrues or is received in accordance with the U.S. holder's normal method of accounting for tax purposes.

Amounts included in income with respect to your Note will be interest income from sources outside the United States subject to the rules regarding the foreign tax credit allowable to a U.S. holder. Under the foreign tax credit rules, interest paid in taxable years beginning before January 1, 2007 will generally be "passive" or "financial services" income, while interest paid in taxable years beginning after December 31, 2006 will generally be "passive" or "general" income which, in either case, is treated separately from other types of income for purposes of computing the foreign tax credit.

Original Issue Discount

The following is a summary of the principal federal income tax consequences of the ownership of notes having original issue discount.

A note will have original issue discount for federal income tax purposes if its "issue price" is less than its "stated redemption price at maturity" by more than a de minimis amount, as discussed below, and it has a term of more than one year.

The issue price of a note generally is the first price at which a substantial amount of the "issue" of notes is sold to the public for money (excluding sales to bond houses, brokers or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers), excluding pre-issuance accrued interest (as discussed below under "—Pre-Issuance Accrued Interest"). You may obtain the price of each note by contacting Structuring, Investor Solutions Americas at (212) 412-1101.

The "stated redemption price at maturity" of a note generally is the total amount of all payments provided by the note other than "qualified stated interest" payments.

Qualified stated interest generally is stated interest that is "unconditionally payable" in cash or property (other than debt instruments of the issuer) at least annually either at a single fixed rate, or a "qualifying variable rate" (as described below). Qualified stated interest is taxable to a U.S. holder when accrued or received in accordance with the U.S. holder's normal method of tax accounting.

Interest is considered unconditionally payable only if reasonable legal remedies exist to compel timely payment or the note otherwise provides terms and conditions that make the likelihood of late payment (other than a late payment within a reasonable grace period) or non-payment a remote contingency. Interest is payable at a single fixed rate only if the rate appropriately takes into account the length of the interval between stated interest payments. Thus, if the interval between payments varies during the term of the instrument, the value of the fixed rate on which payment is based generally must be adjusted to reflect a compounding assumption consistent with the length of the interval preceding the payment.

Notes having "*de minimis* original issue discount" generally will be treated as not having original issue discount unless a U.S. holder elects to treat all interest on the note as original issue discount. See "—Election to Treat All Interest and Discount as Original Issue Discount (Constant Yield Method)". A note will be considered to have "*de minimis* original issue discount" if the difference between its stated redemption price at maturity and its issue price is less than the product of 1/4 of 1 percent of the stated redemption price at maturity and the number of complete years from the issue date to maturity (or the weighted average maturity in the case of a note that provides for payment of an amount other than qualified stated interest before maturity). U.S. holders of notes having original issue discount will be required to include original issue discount in gross income for federal income tax

Table of Contents

purposes as it accrues (regardless of the U.S. holders' method of accounting), which may be in advance of receipt of the cash attributable to that income. Original issue discount accrues under the constant yield method, based on a compounded yield to maturity, as described below. Accordingly, U.S. holders of notes having original issue discount will generally be required to include in income increasingly greater amounts of original issue discount in successive accrual periods.

The annual amount of original issue discount includible in income by the initial U.S. holder of a note having original issue discount will equal the sum of the "daily portions" of the original issue discount with respect to the note for each day on which the U.S. holder held the note during the taxable year. Generally, the daily portions of original issue discount are determined by allocating to each day in an "accrual period" the ratable portion of original issue discount allocable to the accrual period. The term accrual period means an interval of time with respect to which the accrual of original issue discount is measured and which may vary in length over the term of the note provided that each accrual period is no longer than one year and each scheduled payment of principal or interest occurs on either the first or last day of an accrual period.

The amount of original issue discount allocable to an accrual period will be the excess of:

- the product of the "adjusted issue price" of the note at the commencement of the accrual period and its "yield to maturity" over
- the amount of any qualified stated interest payments allocable to the accrual period.

The adjusted issue price of a note at the beginning of the first accrual period is its issue price and, on any day thereafter, it is the sum of the issue price and the amount of original issue discount previously includible in the gross income of the U.S. holder (without regard to any "acquisition premium" as described below), reduced by the amount of any payment other than a payment of qualified stated interest previously made on the note. If an interval between payments of qualified stated interest contains more than one accrual period, the amount of qualified stated interest that is payable at the end of the interval (including any qualified stated interest that is payable on the first day of the accrual period immediately following the interval) is allocated on a pro-rata basis to each accrual period in the interval, and the adjusted issue price at the beginning of each accrual period in the interval is increased by the amount of any qualified stated interest that has accrued prior to the first day of the accrual period but is not payable until the end of the interval. The yield to maturity of a note is the yield to maturity computed on the basis of compounding at the end of each accrual period properly adjusted for the length of the particular accrual period. If all accrual periods are of equal length except for a shorter initial and/or final accrual period(s), the amount of original issue discount allocable to the initial period may be computed using any reasonable method; however, the original issue discount allocable to the final accrual period will always be the difference between the amount payable at maturity (other than a payment of qualified stated interest) and the adjusted issue price at the beginning of the final accrual period.

Pre-Issuance Accrued Interest

If (i) a portion of the initial purchase price of a note is attributable to pre-issuance accrued interest, (ii) the first stated interest payment on the note is to be made within one year of the note's issue date, and (iii) the payment will equal or exceed the amount of pre-issuance accrued interest, then the U.S. holder may compute the issue price of the note by subtracting the amount of the pre-issuance accrued interest. In that event, a portion of the first stated interest payment will be treated as a return of the excluded pre-issuance accrued interest and not as an amount payable on the note.

Notes Subject to Call or Put Options

For purposes of calculating the yield and maturity of a note subject to an option, in general, a call option held by the issuer is presumed exercised if, upon exercise, the yield on the note is less than it would have been had the option not been exercised, and a put option held by a U.S. holder is presumed exercised if, upon exercise, the yield on the note is more than it would have been had the option not been exercised. The effect of this rule generally may accelerate or defer the inclusion of original issue discount in the income of a U.S. holder whose note is subject to a put option or a call option, as

Table of Contents

compared to a note that does not have those options. The applicable pricing supplement will indicate whether a put option or call option will be presumed to be exercised and the effect of that presumption. If any option that is presumed to be exercised is not in fact exercised, the note is treated as reissued solely for purposes of the original issue discount rules on the date of presumed exercise for an amount equal to its adjusted issue price on that date. The deemed reissuance will have the effect of redetermining the note's yield and maturity for original issue discount purposes and any related subsequent accruals of original issue discount.

Variable Rate Debt Instruments

Some notes that are treated as "variable rate debt instruments" are subject to special rules described below. The applicable pricing supplement will indicate whether we intend to treat a note as a variable rate debt instrument that is subject to these special rules.

If a variable rate debt instrument bears interest that is unconditionally payable or compounds at least annually at a single qualified floating rate or objective rate (including a qualified inverse floating rate), all stated interest is treated as qualified stated interest. The accrual of any original issue discount is determined by assuming the note bears interest at a fixed interest rate equal to the issue date value of the qualified floating rate or qualified inverse floating rate or, in the case of any other objective rate, a fixed internal rate that is equal to the reasonably expected yield for the note. The qualified stated interest allocable to an accrual period is increased (or decreased) if the interest actually paid during an accrual period exceeds (or is less than) the interest assumed to be paid during the accrual period. The applicable pricing supplement will indicate whether a note is subject to these rules.

If a variable rate debt instrument bears interest at a qualifying variable rate other than a single qualified floating rate or objective rate, the amount and accrual of original issue discount generally are determined by (i) determining a fixed rate substitute for each variable rate as described in the preceding paragraph, (ii) determining the amount of qualified stated interest and original issue discount by assuming the note bears interest at those substitute fixed rates and (iii) making appropriate adjustments to the qualified stated interest and original issue discount so determined for actual interest rates under the note. However, if that qualifying variable rate includes a fixed rate (other than certain initial fixed rates), the note is treated for purposes of applying clause (i) of the preceding sentence as if it provided for an assumed qualified floating rate (or qualified inverse floating rate if the actual variable rate is such) that would cause the note to have approximately the same fair market value, and the rate is used in lieu of the fixed rate. The applicable pricing supplement will indicate whether a note is subject to these rules.

Short-Term Obligations

Certain notes that are treated as "short-term obligations" are subject to special rules. The applicable pricing supplement will indicate whether we intend to treat the notes as short-term obligations. A note that is a short-term obligation will be acquired with "acquisition discount" equal to all payments under the note over the U.S. holder's basis in the note. U.S. holders that report income for federal income tax purposes on the accrual method and certain other holders are required to include original issue discount (equal to the difference between all payments on the note over its issue price) in income or, if the U.S. holder elects, acquisition discount with respect to a note that is a short-term obligation. Original issue discount or acquisition discount on notes that are short-term obligations is accrued on a straight-line basis, unless an irrevocable election with respect to the note is made to accrue the original issue discount or acquisition discount under the constant yield method based on daily compounding.

In general, an individual or other cash method U.S. holder of a short-term obligation is not required to accrue original issue discount or acquisition discount with respect to a note that is a short-term obligation, unless the U.S. holder elects to do so. An election by a cash basis U.S. holder to accrue original issue discount on a note that is a short-term obligation, as well as the election to accrue acquisition discount instead of original issue discount with respect to a note that is a short-term obligation, applies to all short-term obligations acquired by the U.S. holder during the first taxable year for which the election is made, and all subsequent taxable years of the U.S. holder, unless the Internal

Table of Contents

Revenue Service (the "IRS") consents to a revocation. In the case of a U.S. holder that is not required (and does not elect) to include original issue discount or acquisition discount in income currently, any gain realized on the sale, exchange or other taxable disposition of a note that is a short-term obligation is treated as ordinary income to the extent of the original issue discount that had accrued on a straight-line basis (or, if elected, under the constant yield method based on daily compounding) through the date of sale, exchange or other disposition, and the U.S. holder will be required to defer deductions for any interest paid on indebtedness incurred or continued to purchase or carry the note in an amount not exceeding the accrued original issue discount (determined on a ratable basis, unless the U.S. holder elects to use a constant yield basis) on the note, until the original issue discount is recognized.

In general, the treatment of accrual method U.S. holders and cash method U.S. holders that elect to accrue discount currently on short-term obligations that provide for contingent interest is uncertain. Under one approach, the U.S. holder would wait until the maturity of a note to accrue the discount, even if the term of the note spans a taxable year. Under another approach, a U.S. holder would apply rules analogous to the rules that apply to "contingent payment debt instruments" as described below under "—Contingent Payment Debt Instruments" and would accrue acquisition discount at our comparable yield (i.e., the yield at which we would issue a fixed-rate noncontingent debt instrument with terms and conditions similar to those of the notes). Prospective purchasers can obtain the comparable yield of the notes by contacting Structuring, Investors Solutions Americas at (212) 412-1101. Under this approach, if the actual contingent payment received is less than the accrued discount based on the comparable yield, then the U.S. holder would first reduce the acquisition discount accrued for the year in which the contingent payment is paid, and any remainder of the difference between the accrued discount and the actual contingent payment would be treated as an ordinary loss that is not subject to limitations on the deductibility of miscellaneous deductions. Other approaches may be possible. Prospective investors that are accrual method U.S. holders or cash method U.S. holders that elect to accrue the discount currently should consult with their tax advisors regarding the appropriate method of accruing the discount on short-term obligations that provide for contingent interest. Cash method U.S. holders that do not elect to accrue the discount currently should include contingent payments on short-term obligations in income upon receipt.

Market Discount and Premium

If a U.S. holder purchases a note, other than a contingent payment debt instrument or a short-term obligation, for an amount that is less than its stated redemption price at maturity or, in the case of a note having original issue discount, less than its revised issue price (which is the sum of the issue price of the note and the aggregate amount of the original issue discount previously includible in the gross income of any holder (without regard to any acquisition premium)), the amount of the difference generally will be treated as market discount for federal income tax purposes. (It is possible that a U.S. holder may purchase a note at original issuance for an amount that is different than its issue price.) The amount of any market discount generally will be treated as de minimis and disregarded if it is less than the product of 1/4 of 1 percent of the stated redemption price at maturity of the note and the number of complete years to maturity (or weighted average maturity in the case of notes paying any amount other than qualified stated interest prior to maturity).

Under the market discount rules, a U.S. holder is required to treat any principal payment on, or any gain on the sale, exchange, redemption or other disposition of, a note as ordinary income to the extent of any accrued market discount that has not previously been included in income. If the note is disposed of in a nontaxable transaction (other than certain specified nonrecognition transactions), accrued market discount will be includible as ordinary income to the U.S. holder as if the U.S. holder had sold the note at its then fair market value. In addition, the U.S. holder may be required to defer, until the maturity of the note or its earlier disposition in a taxable transaction, the deduction of all or a portion of the interest expense on any indebtedness incurred or continued to purchase or carry the note.

Market discount accrues ratably during the period from the date of acquisition to the maturity of a note, unless the U.S. holder elects to accrue it under the constant yield method. A

Table of Contents

U.S. holder of a note may elect to include market discount in income currently as it accrues (either ratably or under the constant yield method), in which case the rule described above regarding deferral of interest deductions will not apply. The election to include market discount currently applies to all market discount obligations acquired during or after the first taxable year to which the election applies and may not be revoked without the consent of the IRS. If an election is made to include market discount in income currently, the basis of the note in the hands of the U.S. holder will be increased by the market discount thereon as it is included in income.

A U.S. holder that purchases a note having original issue discount, other than a contingent payment debt instrument or a short-term obligation, for an amount exceeding its "adjusted issue price" (which is described above under "—Original Issue Discount") and less than or equal to the sum of all remaining amounts payable on the note other than payments of qualified stated interest will be treated as having purchased the note with acquisition premium. The amount of original issue discount that the U.S. holder must include in gross income with respect to that note will be reduced in the proportion that the excess bears to the original issue discount remaining to be accrued as of the note's acquisition and ending on the maturity date. Rather than apply the above fraction, the U.S. holder that, as discussed below, elects to treat all interest as original issue discount would treat the purchase at an acquisition premium as a purchase at an original issuance and calculate original issue discount accruals on a constant yield to maturity.

A U.S. holder that acquires a note, other than a contingent payment debt instrument, for an amount that is greater than the sum of all remaining amounts payable on the note other than payments of qualified stated interest will be treated as having purchased the note at a bond premium and will not be required to include any original issue discount in income. A U.S. holder generally may elect to amortize bond premium. The election to amortize bond premium must be made with a timely filed federal income tax return for the first taxable year to which the U.S. holder wishes the election to apply.

If the bond premium is amortized, the amount of interest that must be included in the U.S. holder's income for each period ending on an interest payment date or on stated maturity, as the case may be, will be reduced by the portion of the bond premium allocable to that period based on the note's yield to maturity (or, in some circumstances, until an earlier call date) determined by using the U.S. holder's basis of the note, compounding at the close of each accrual period. If the bond premium allocable to an accrual period is in excess of qualified stated interest allocable to that period, the excess may be deducted to the extent of prior income inclusions and is then carried to the next accrual period and offsets qualified stated interest in that period. If an election to amortize the bond premium is not made, a U.S. holder must include the full amount of each interest payment in income in accordance with its regular method of accounting and will receive a tax benefit from the premium only in computing its gain or loss upon the sale, exchange, redemption or other disposition or payment of the principal amount of the note.

An election to amortize the bond premium will apply to amortizable bond premium on all notes and other bonds, the interest on which is includible in the U.S. holder's gross income, held at the beginning of the U.S. holder's first taxable year to which the election applies or thereafter acquired, and may be revoked only with the consent of the IRS. The election to treat all interest as original issue discount is treated as an election to amortize premium. Special rules may apply if a note is subject to call prior to maturity at a price in excess of its stated redemption price at maturity.

Election to Treat All Interest and Discount as Original Issue Discount (Constant Yield Method)

A U.S. holder of a note may elect to include in income all interest and discount (including de minimis original issue discount and de minimis market discount), as adjusted by any premium with respect to the note, based on a constant yield method, which is described above under "—Original Issue Discount". The election is made for the taxable year in which the U.S. holder acquired the note, and it may not be revoked without the consent of the IRS. If that election is made with respect to a note having market discount, the U.S. holder will be deemed to have elected currently to include market discount on a constant yield basis with respect

Table of Contents

to all debt instruments having market discount acquired during the year of election or thereafter. If made with respect to a note having amortizable bond premium, the U.S. holder will be deemed to have made an election to amortize premium generally with respect to all debt instruments having amortizable bond premium held by the U.S. holder during the year of election or thereafter.

Sale, Exchange, Redemption or Repayment of the Notes

Upon the disposition of a note by sale, exchange, redemption, repayment of principal at maturity or other taxable disposition, a U.S. holder will generally recognize taxable gain or loss equal to the difference between (i) the amount realized on the disposition (other than amounts attributable to accrued but untaxed interest) and (ii) the U.S. holder's adjusted tax basis in the note. A U.S. holder's adjusted tax basis in a note generally will equal the cost of the note (net of accrued interest) to the U.S. holder, increased by amounts includible in income as original issue discount or market discount, as described above (if the holder elects to include market discount in income on a current basis) and reduced by any amortized bond premium and any payments (other than payments of qualified stated interest) made on the note.

Because the note is held as a capital asset, such gain or loss (except to the extent that the market discount rules or the rules relating to short-term obligations otherwise provide) will generally constitute capital gain or loss. Capital gains of individual taxpayers from the sale, exchange or other disposition of a note held for more than one year may be eligible for reduced rates of taxation. The deductibility of a capital loss realized on the sale, exchange, or other disposition of a note is subject to limitations.

Contingent Payment Debt Instruments

Certain notes that are treated as "contingent payment debt instruments" are subject to special rules. The applicable pricing supplement will indicate whether we intend to treat a note as a contingent payment debt instrument. If a contingent payment debt instrument is issued for cash or publicly traded property, original issue discount is determined and accrued under the "noncontingent bond method". Unless otherwise indicated in the applicable pricing supplement, we intend to treat all notes that are treated as contingent payment debt instruments as subject to the noncontingent bond method.

Under the noncontingent bond method, for each accrual period, U.S. holders of the notes accrue original issue discount equal to the product of (i) the "comparable yield" (adjusted for the length of the accrual period) and (ii) the "adjusted issue price" of the notes at the beginning of the accrual period. This amount is ratably allocated to each day in the accrual period and is includible as ordinary interest income by a U.S. holder for each day in the accrual period on which the U.S. holder holds the contingent payment debt instrument, whether or not the amount of any payment is fixed or determinable in the taxable year. Thus, the noncontingent bond method may result in recognition of income prior to the receipt of cash.

In general, the comparable yield of a contingent payment debt instrument is equal to the yield at which the issuer would issue a fixed rate debt instrument with terms and conditions similar to those of the contingent payment debt instrument, including level of subordination, term, timing of payments, and general market conditions. For example, if a hedge of the contingent payment debt instrument is available that, if integrated with the contingent payment debt instrument, would produce a "synthetic debt instrument" with a specific yield to maturity, the comparable yield will be equal to the yield of the synthetic debt instrument. However, if such a hedge is not available, but similar fixed rate debt instruments of the issuer are traded at a price that reflects a spread above a benchmark rate, the comparable yield is the sum of the benchmark rate on the issue date and the spread. Prospective purchasers can obtain the comparable yield of the notes by contacting Structuring, Investors Solutions Americas at (212) 412-1101.

The adjusted issue price at the beginning of each accrual period is generally equal to the issue price of the note plus the amount of original issue discount previously includible in the gross income of the U.S. holder less any noncontingent payment and the projected amount of any contingent payment contained in the projected payment schedule (as described below) previously made on the contingent payment debt instrument.

Table of Contents

In addition to the determination of a comparable yield, the noncontingent bond method requires the construction of a projected payment schedule. The projected payment schedule includes all noncontingent payments and projected amounts for each contingent payment to be made under the contingent payment debt instrument that are adjusted to produce the comparable yield. Prospective purchasers can obtain the projected payment schedule of the notes by contacting Structuring, Investors Solutions Americas at (212) 412-1101. The projected payment schedule remains fixed throughout the term of the contingent payment debt instrument. A U.S. holder is required to use the issuer's projected payment schedule to determine its interest accruals and adjustments, unless the U.S. holder determines that the issuer's projected payment schedule is unreasonable, in which case the U.S. holder must disclose its own projected payment schedule in connection with its federal income tax return and the reason(s) why it is not using the issuer's projected payment schedule.

If the actual amounts of contingent payments are different from the amounts reflected in the projected payment schedule, a U.S. holder is required to make adjustments in its accruals under the noncontingent bond method described above when those amounts are paid. Adjustments arising from contingent payments that are greater than the assumed amounts of those payments are referred to as "positive adjustments"; adjustments arising from contingent payments that are less than the assumed amounts are referred to as "negative adjustments". Positive and negative adjustments are netted for each taxable year with respect to each note. Any net positive adjustment for a taxable year is treated as additional original issue discount income of the U.S. holder. Any net negative adjustment reduces any original issue discount on the note for the taxable year that would otherwise accrue. Any excess is then treated as a current-year ordinary loss to the U.S. holder to the extent of original issue discount accrued in prior years. The balance, if any, is treated as a negative adjustment in subsequent taxable years. Finally, to the extent that it has not previously been taken into account, an excess negative adjustment reduces the amount realized upon a sale, exchange, redemption or other taxable disposition of the note.

A U.S. holder's basis in a contingent payment debt instrument is increased by the projected contingent payments accrued by the holder under the projected payment schedule (as determined without regard to adjustments made to reflect differences between actual and projected payments) and reduced by the amount of any noncontingent payments and the projected amount of any contingent payments previously made. Gain on the sale, exchange, redemption or other taxable disposition of a contingent payment debt instrument generally is treated as ordinary income. Loss, on the other hand, is treated as ordinary only to the extent of the U.S. holder's prior net original issue discount inclusions (i.e., reduced by the total net negative adjustments previously allowed to the U.S. holder as an ordinary loss) and capital to the extent in excess thereof. The deductibility of a capital loss realized on the sale, exchange or other taxable disposition of a note is subject to limitations.

A U.S. holder that purchases a note for an amount other than the issue price of the note will be required to adjust its original issue discount inclusions to account for the difference. These adjustments will affect the U.S. holder's basis in the note. Reports to U.S. holders may not include these adjustments. U.S. holders that purchase notes at other than the issue price should consult their tax advisors regarding these adjustments.

Prospective investors should consult their own tax advisors with respect to the application of the contingent payment debt instrument provisions to notes.

Amortizing Notes

Payments received pursuant to an amortizing note may consist of both a principal and an interest component. The principal component will generally constitute a tax-free return of capital that will reduce a U.S. holder's adjusted tax basis in the note.

Foreign Currency Notes

Certain notes that are denominated in or indexed to a foreign currency are subject to special rules. The applicable pricing supplement will indicate whether we intend to treat the notes as subject to these special rules. The following discussion summarizes the principal federal

Table of Contents

income tax consequences of owning a note that is denominated in or indexed to a foreign currency (other than a currency described in this section that is considered "hyperinflationary") and is not a contingent payment debt instrument or a dual currency note. Special federal income tax considerations applicable to notes that are denominated in or indexed to a hyperinflationary currency, are contingent payment debt instruments, or are dual currency notes, will be discussed in the applicable pricing supplement.

In general, a U.S. holder that uses the cash method of accounting and holds a note will be required to include in income the U.S. dollar value of the amount of interest income received, whether or not the payment is received in U.S. dollars or converted into U.S. dollars. The U.S. dollar value of the amount of interest received is the amount of the interest paid in the foreign currency, translated into U.S. dollars at the spot rate on the date of receipt. The U.S. holder will not have exchange gain or loss on the interest payment itself, but may have exchange gain or loss when it disposes of any foreign currency received.

A U.S. holder that uses the accrual method of accounting is generally required to include in income the dollar value of interest accrued during the accrual period. Accrual basis U.S. holders may determine the amount of income recognized with respect to that interest in accordance with either of two methods. Under the first method, the dollar value of accrued interest is translated at the average rate for the interest accrual period (or, with respect to an accrual period that spans two taxable years, the partial period within the taxable year). For this purpose, the average rate is the simple average of spot rates of exchange for each business day of that period or other average exchange rate for the period reasonably derived and consistently applied by the U.S. holder. Under the second method, a U.S. holder can elect to accrue interest at the spot rate on the last day of the interest accrual period (in the case of a partial accrual period, the last day of the taxable year) or, if the last day of an interest accrual period is within five business days of the receipt, the spot rate on the date of receipt. Any such election will apply to all debt instruments held by the U.S. holder and is irrevocable without the consent of the IRS. An accrual basis U.S. holder will recognize exchange gain or loss, as the case may be, on the receipt of a foreign currency interest payment if the exchange rate on the date payment is received differs from the rate applicable to the previous accrual of that interest income. The foreign currency gain or loss will generally be treated as U.S. source ordinary income or loss.

Original issue discount on a note described in this section is determined in the foreign currency and is translated into U.S. dollars in the same manner that an accrual basis U.S. holder accrues stated interest. Exchange gain or loss is determined when original issue discount is considered paid to the extent the exchange rate on the date of payment differs from the exchange rate at which the original issue discount was accrued.

The amount of market discount on a note described in this section includible in income will generally be determined by computing the market discount in the foreign currency and translating that amount into dollars at the spot rate on the date the note is retired or otherwise disposed of. If the U.S. holder accrues market discount currently, the amount of market discount which accrues during any accrual period is determined in the foreign currency and translated into U.S. dollars on the basis of the average exchange rate in effect during the accrual period. Exchange gain or loss may be recognized to the extent that the rate of exchange on the date of the retirement or disposition of the note differs from the exchange rate at which the market discount was accrued.

Amortizable bond premium on a note described in this section is computed in units of foreign currency and, if the U.S. holder elects, will reduce interest income in units of foreign currency. At the time amortized bond premium offsets interest income (i.e., the last day of the tax year in which the election is made and the last day of each subsequent tax year), exchange gain or loss with respect to amortized bond premium is recognized and is measured by the difference between exchange rates at that time and at the time of the acquisition of the note.

With respect to the sale, exchange, redemption or other disposition of a note denominated in a foreign currency, the foreign currency amount realized will be considered to be first, the payment of accrued but unpaid interest (on which exchange gain or loss is recognized as described above); second, accrued but unpaid

Table of Contents

original issue discount (on which exchange gain or loss is recognized as described above); and, finally, as receipt of principal. With respect to principal, exchange gain or loss is equal to the difference between (i) the foreign currency principal amount translated on the date the payment is received or the date of disposition and (ii) the foreign currency principal amount translated on the date the note was acquired, or deemed acquired. Exchange gain or loss computed on accrued interest, original issue discount, market discount and principal is realized, however, only to the extent of total gain or loss on the transaction. The conversion of U.S. dollars into a foreign currency and the immediate use of that currency to purchase a note described in this section generally will not result in a taxable gain or loss for a U.S. holder.

Certain Other Debt Securities

Some notes may be subject to special rules. The applicable pricing supplement will discuss the principal federal income tax consequences with respect to notes that are subject to special rules, including notes that provide for an extendible maturity an alternative payment schedule or schedules applicable upon the occurrence of a contingency or contingencies relating to payments of interest or of principal.

Certain Notes Treated as Forward Contracts or Executory Contracts

We may treat some notes as a forward contract or executory contract for federal income tax purposes. The applicable pricing supplement will indicate whether we intend to treat a note as a forward contract or executory contract for federal income tax purposes. This section describes the principal federal income tax consequences of the purchase, beneficial ownership and disposition of a note that we intend to treat as a forward contract or executory contract.

There are no regulations, published rulings or judicial decisions addressing the treatment for federal income tax purposes of notes with terms that are substantially the same as those described in this section. Accordingly, the proper federal income tax treatment of the notes described in this section is uncertain. Under one approach, the notes would be treated as forward contracts or executory contracts with respect to the reference asset. We intend to treat each note described in this section consistent with this approach, and pursuant to the terms of the notes, each holder agrees to that treatment for all federal income tax purposes. Except for the possible alternative treatments described below, the balance of this summary assumes that the notes described in this section are so treated.

Unless otherwise indicated in the applicable pricing supplement, if a note that is treated as a forward contract or executory contract provides for current interest payments, we intend to treat that interest as ordinary income at the time it accrues or is received in accordance with the U.S. holder's normal method of accounting for tax purposes.

A U.S. holder's tax basis in a note described in this section generally will equal the U.S. holder's cost for the note. Upon receipt of cash upon maturity or redemption and upon the sale, exchange or other disposition of the note, a U.S. holder generally will recognize gain or loss equal to the difference between the amount realized at maturity or on the redemption, sale, exchange or other disposition and the U.S. holder's tax basis in the note. Any such gain upon the maturity, redemption, sale, exchange or other disposition of the note generally will constitute capital gain. Capital gain of non-corporate taxpayers from the maturity, redemption, sale, exchange or other disposition of a note treated as a forward contract or executory contract and held for more than one year may be eligible for reduced rates of taxation. Any loss from the maturity, redemption, sale, exchange or other disposition of a note treated as a forward contract or executory contract will generally constitute a capital loss. The ability of U.S. holders to use capital losses to offset ordinary income is limited.

Although we intend to treat each note described in this section as a forward contract or executory contract as described above, there are no regulations, published rulings or judicial decisions addressing the characterization of securities with terms that are substantially the same as those of the notes described in this section, and therefore the notes could be subject to some other characterization or treatment for federal income tax purposes. For example, the notes could be treated as "contingent payment debt instruments" for federal income tax purposes. In this case, in general, U.S. holders should be treated as described above under "—Contingent Payment Debt Instruments".

Table of Contents

In addition, certain proposed Treasury regulations require the accrual of income on a current basis for contingent payments made under certain "notional principal contracts". The preamble to the proposed regulations states that the "wait and see" method of accounting does not properly reflect the economic accrual of income on those contracts, and requires current accrual of income for some contracts already in existence. While the proposed regulations do not apply to pre-paid forward contracts, the preamble to the proposed regulations indicates that similar timing issues exist in the case of pre-paid forward contracts. If the IRS or the U.S. Treasury Department publishes future guidance requiring current economic accrual for contingent payments on pre-paid forward contracts, it is possible that a U.S. holder could be required to accrue income over the term of the notes described in this section. In addition, other alternative federal income tax characterizations or treatments of the notes described in this section are possible, and if applied could also affect the timing and the character of the income or loss with respect to the notes.

Finally, it is possible that the IRS could assert that U.S. holders should be subject to the "constructive ownership" rules set forth in Section 1260 of the Code. Specifically, Section 1260 of the Code treats a taxpayer owning certain types of derivative positions in property as having "constructive ownership" in that property, with the result that all or a portion of the long-term capital gain recognized by that taxpayer with respect to the derivative position may be recharacterized as ordinary income. In addition, Section 1260 imposes an interest charge on the long-term capital gain that was recharacterized. Unless otherwise provided in the applicable pricing supplement, we intend to treat the notes as not subject to Section 1260 in its current form. However, Section 1260 authorizes the Treasury Department to promulgate regulations (possible with retroactive effect) to expand the application of the "constructive ownership" regime. If these regulations were promulgated and caused Section 1260 were to apply to the notes, a U.S. holder would be required to treat all or a portion of the long-term capital gain (if any) that it recognizes on sale, exchange, maturity, or other taxable disposition of the notes as ordinary income, but only to the extent such long-term capital gain exceeds the long-term capital gain that it would have recognized if it had made a direct investment in shares of the reference asset (or, possibly, of entities underlying a reference asset). It is possible that these rules could apply, for example, to recharacterize long-term capital gain on the notes in whole or in part to the extent that a holder of shares of the relevant reference assets or, possibly, of entities underlying a reference asset) would have earned dividend income therefrom or would have recognized short-term capital gain from the disposition of the shares upon a rebalancing of the reference assets or, possibly, of entities underlying a reference asset) between the issue date for the notes and the date of the disposition of the notes.

Prospective investors in the notes described in this section should consult their tax advisors as to the tax consequences to them of purchasing the notes, including any alternative characterizations and treatments.

Certain Notes Treated as Deposits and Put Options

This section describes the U.S. federal income tax consequences of the purchase, beneficial ownership and disposition of notes that are described in the applicable pricing supplement as "reverse convertible notes".

There are no regulations, published rulings or judicial decisions addressing the treatment for federal income tax purposes of notes with terms that are substantially the same as those described in this section. Accordingly, the proper federal income tax treatment of the notes described in this section is uncertain. Under one approach, each note should be treated as a put option written by the holder (the "Put Option") that permits us to (1) sell the linked shares to the holder at maturity for an amount equal to the Deposit (as described below), plus any accrued and unpaid interest, acquisition discount and/or original issue discount on the Deposit (as described below), or (2) "cash settle" the Put Option (*i.e.*, require the holder to pay to us at maturity the difference between the Deposit (plus any accrued and unpaid interest, acquisition discount, and/or original issue discount on the Deposit) and the value of the linked shares at that time), and a deposit with us

Table of Contents

of cash in an amount equal to the purchase price of the note (the "Deposit") to secure the holder's potential obligation under the Put Option. We intend to treat each note described in this section consistent with this approach, and pursuant to the terms of the notes, each holder agrees to this treatment for all federal income tax purposes. Except for the possible alternative treatments described below, the balance of this summary assumes that the notes described in this section are so treated.

We intend to treat a portion of any stated interest payments and/or discount on a reverse convertible note as a put premium paid to us in respect of the Put Option (the "Put Premium") and the remainder as interest and/or original issue discount or acquisition discount on the Deposit. The applicable pricing supplement will indicate the portion of the stated interest or discount that is allocable to Put Premium and the portion that is allocable to interest, original issue discount or acquisition discount on the Deposit. By purchasing the notes each holder agrees to this treatment.

Tax Treatment of Put Premium on the Put Option

The Put Premium should not be taxable to a U.S. holder upon its receipt. If the Put Option expires unexercised (i.e., the payment at maturity is equal to the full principal amount of the notes), the U.S. holder should recognize the total Put Premium received as short-term capital gain at that time.

If we exercise the Put Option and sell the linked shares to a U.S. holder, the U.S. holder should not recognize any gain or loss (other than with respect to cash received in lieu of fractional shares, as described below) in respect of the Put Option. In this event, the U.S. holder should have an adjusted tax basis in all linked shares received (including for this purpose any fractional shares) equal to the principal amount of the note less the total Put Premium received. The U.S. holder's holding period for any linked shares received should start on the day after the delivery of the linked shares. The U.S. holder should generally recognize a short-term capital gain or loss with respect to cash received in lieu of fractional shares in an amount equal to the difference between the amount of that cash received and the U.S. holder's basis in the fractional shares, which is equal to the U.S. holder's basis in all of the linked shares (including the fractional shares), times a fraction, the numerator of which is the fractional shares and the denominator of which is all of the linked shares (including fractional shares).

U.S. holders and non-U.S. holders should consult the offering documents for the linked shares for the U.S. federal income tax treatment of acquiring, owning and selling the linked shares.

If we elect to cash settle the Put Option, a U.S. holder should generally recognize a short-term capital gain or loss equal to (i) the amount of cash received on the note less (ii) the principal amount of the note, less the total Put Premium received.

Tax Treatment of the Deposit

Unless otherwise indicated in the applicable pricing supplement, if the term of a reverse convertible note is more than one year, U.S. holders should include the portion of the stated interest payments on the note that is treated as interest income as described above under "—Payments of Interest". If the term of a reverse convertible note is one year or less, the Deposit should be treated as a short-term obligation, and the portion of the stated interest payments on the note that is treated as interest income should be treated as described above under "—Short-Term Obligations". The tax treatment of a Deposit issued with OID is described above under "—Original Issue Discount". The applicable pricing supplement will indicate whether the Deposit is issued with OID.

Sale or Exchange of the Notes

Upon a sale, redemption, or other taxable disposition of a reverse convertible note for cash, a U.S. holder should allocate the cash received between the Deposit and the Put Option on the basis of their respective values on the date of sale. The U.S. holder should generally recognize gain or loss with respect to the Deposit in an amount equal to the difference between the amount of the sales proceeds allocable to the Deposit (less accrued and unpaid "qualified stated interest" and accrued acquisition discount that the U.S. holder has not included in income currently, which will be treated as ordinary interest income) and the U.S. holder's adjusted tax basis in the Deposit (which

Table of Contents

generally will equal the initial purchase price of the U.S. holder's reverse convertible note increased by any accrued original issue discount or acquisition discount previously included in income on the Deposit and decreased by the amount of any payment (other than an interest payment that is treated as qualified stated interest) received on the Deposit). This gain or loss should be capital gain or loss and should be long-term capital gain or loss if a U.S. holder is treated as having held the Deposit for more than one year at the time of such disposition. If the Put Option has a positive value on the date of a sale of a reverse convertible note, the U.S. holder should recognize short-term capital gain equal to the portion of the sale proceeds allocable to the Put Option plus any previously received Put Premium. If the Put Option has a negative value on the date of sale, the U.S. holder should be treated as having paid the buyer an amount equal to the negative value in order to assume the U.S. holder's rights and obligations under the Put Option. In that case, the U.S. holder should recognize a short-term capital gain or loss in an amount equal to the difference between the total Put Premium previously received and the amount of the payment deemed made by the U.S. holder with respect to the assumption of the Put Option. The amount of the deemed payment will be added to the sales price allocated to the Deposit in determining the gain or loss in respect of the Deposit. The deductibility of capital losses by U.S. holders is subject to limitations.

Alternative Characterizations and Treatments

Although we intend to treat each reverse convertible note as a Deposit and a Put Option as described above, there are no regulations, published rulings or judicial decisions addressing the treatment for federal income tax purposes of notes with terms that are substantially the same as those described in this section, and therefore the reverse convertible notes could be subject to some other characterization or treatment for U.S. federal income tax purposes. For example, the reverse convertible notes could be treated as "contingent payment debt instruments" for U.S. federal income tax purposes as described above under "—Contingent Payment Debt Instruments". In addition, other alternative characterizations and treatments of the reverse convertible notes are possible, and if applied could also affect the timing and the character of the income or loss with respect to the notes.

Prospective investors in the notes should consult their tax advisors as to the tax consequences to them of purchasing the notes, including any alternative characterizations and treatments.

Tax Treatment of Non-U.S. Holders

In general, payments on the notes to a non-U.S. holder and gain realized on the sale, exchange, redemption or other disposition of the notes by a non-U.S. holder will not be subject to U.S. federal income or withholding tax, unless (i) such income is effectively connected with a trade or business conducted by such non-U.S. holder in the United States, (ii) in the case of gain, such non-U.S. holder is a nonresident alien individual who holds the notes as a capital asset and is present in the United States for more than 182 days in the taxable year of the sale and certain other conditions are satisfied, or (iii) such non-U.S. holder fails to provide the relevant correct, complete and executed IRS Form W-8 that eliminates U.S. federal withholding tax.

Information Reporting and Backup Withholding

Distributions made on the notes and proceeds from the sale of notes to or through certain brokers may be subject to a "backup" withholding tax on "reportable payments" unless, in general, the holder complies with certain procedures or is an exempt recipient. Any amounts so withheld from distributions on the notes generally will be refunded by the IRS or allowed as a credit against the holder's federal income tax, provided the holder makes a timely filing of an appropriate tax return or refund claim.

Reports will be made to the IRS and to holders that are not excepted from the reporting requirements.

THE PRECEDING DISCUSSION IS ONLY A SUMMARY OF CERTAIN OF THE TAX IMPLICATIONS OF AN INVESTMENT IN NOTES. PROSPECTIVE INVESTORS ARE URGED TO CONSULT WITH THEIR OWN TAX ADVISORS PRIOR TO INVESTING TO DETERMINE THE TAX IMPLICATIONS OF SUCH INVESTMENT IN LIGHT OF EACH SUCH INVESTOR'S PARTICULAR CIRCUMSTANCES.

Table of Contents

VALIDITY OF SECURITIES

If stated in the pricing supplement applicable to a specific issuance of medium-term notes, the validity of the notes under New York law may be passed upon for us by our U.S. counsel, as specified in that pricing supplement. If stated in the pricing supplement applicable to a specific issuance of notes, the validity of the notes under English law may be passed upon by our English solicitors. Our U.S. counsel may rely upon the opinion as to all matters of English law and our English solicitors may rely on the opinion of our U.S. counsel as to all matters of New York law. If this prospectus supplement is delivered in connection with an underwritten offering, the validity of the notes may be passed upon for the underwriters by U.S. and English counsel for the underwriters specified in the related pricing supplement. If no English counsel is specified, such U.S. counsel to the underwriters may also rely on the opinion of our English solicitors as to certain matters of English law.

Table of Contents

Filed Pursuant to Rule 424(b)(2)
Registration No. 333-126811

BARCLAYS BANK PLC

Debt Securities
Preference Shares
American Depositary Shares

up to an aggregate initial offering price of $12,870,714,000 or the equivalent thereof in other currencies

This prospectus describes some of the general terms that may apply to these securities and the general manner in which they may be offered.

We will give you the specific terms of the securities, and the manner in which they are offered, in supplements to this prospectus. You should read this prospectus and the supplements carefully before you invest. We may offer and sell these securities to or through one or more underwriters, dealers and agents, including Barclays Capital Inc., or directly to purchasers, on a delayed or continuous basis. We will indicate the names of any underwriters in the accompanying prospectus supplement.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined that this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

We may use this prospectus in the initial sale of these securities. In addition, Barclays Capital Inc. or another of our affiliates may use this prospectus in a market-making transaction in any of these securities after their initial sale. ***Unless we or our agent informs you otherwise in the confirmation of sale, this prospectus is being used in a market-making transaction.***

The securities are not deposit liabilities of Barclays Bank PLC and are not insured by the United States Federal Deposit Insurance Corporation or any other governmental agency of the United States, the United Kingdom or any other jurisdiction.

This prospectus may not be used to sell securities unless it is accompanied by a prospectus supplement.

Barclays Capital

The date of this prospectus is September 21, 2005

Table of Contents

TABLE OF CONTENTS

Table of Contents

FORWARD-LOOKING STATEMENTS

This prospectus and certain documents incorporated by reference contain certain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended, with respect to certain of our plans and our current goals and expectations relating to our future financial condition and performance. These forward-looking statements can be identified by the fact that they do not relate only to historical or current facts. Forward-looking statements sometimes use words such as “anticipate”, “target”, “expect”, “estimate”, “intend”, “plan”, “goal”, “believe”, or other words of similar meaning. By their nature, forward-looking statements involve risk and uncertainty because they relate to future events and circumstances, including, but not limited to the further development of standards and interpretations under International Financial Reporting Standards (“IFRS”) applicable to past, current and future periods, evolving practices with regard to the interpretation and application of standards under IFRS and pending tax elections with regards to certain subsidiaries as well as U.K. domestic and global economic and business conditions, market related risks such as changes in interest rates and exchange rates, the policies and actions of governmental and regulatory authorities, changes in legislation, the outcome of pending and future litigation and the impact of competition, a number of which factors are beyond our control. As a result, our actual future results may differ materially from the plans, goals, and expectations set forth in such forward-looking statements. Any forward-looking statements made by or on our behalf speak only as of the date they are made. We do not undertake to update forward-looking statements to reflect any changes in our expectations or any changes in events, conditions or circumstances on which any such statement is based. The reader should, however, consult any additional disclosures that we have made or may make in documents we have filed or may file with the Securities and Exchange Commission, or SEC, including our annual report on Form 20-F for the fiscal year ended December 31, 2004, as amended.

INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

The SEC allows us to “incorporate by reference” the information we file with them, which means we can disclose important information to you by referring you to those documents. The most recent information that we file with the Securities and Exchange Commission automatically updates and supersedes earlier information.

We filed our annual report on Form 20-F for the fiscal year ended December 31, 2004 (the “2004 Form 20-F”) with the SEC on March 24, 2005 and an amendment thereto on May 6, 2005. We have also filed extracts from a results announcement by Barclays PLC for the six months ended June 30, 2005 under cover of Form 6-K with the SEC on August 12, 2005. We are incorporating the 2004 Form 20-F, as amended, and the Form 6-K dated August 12, 2005 by reference into this prospectus.

In addition, we will incorporate by reference into this prospectus all documents that we file with the SEC under Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 (the “Exchange Act”) and, to the extent, if any, we designate therein, reports on Form 6-K we furnish to the SEC after the date of this prospectus and prior to the termination of any offering contemplated in this prospectus.

We will provide to you, upon your written or oral request, without charge, a copy of any or all of the documents we referred to above which we have incorporated in this prospectus by reference, other than certain exhibits to those documents. You should direct your requests to Barclays Bank PLC, 200 Park Avenue, New York, New York 10166, Attention: General Counsel (telephone: 212-412-4000).

PRESENTATION OF FINANCIAL INFORMATION

We prepared our consolidated financial statements for the year ended December 31, 2004 in accordance with generally accepted accounting standards in the United Kingdom (“U.K. GAAP”), which differs in certain significant respects from U.S. GAAP. For a discussion of significant differences between U.K. GAAP and U.S. GAAP and a reconciliation of consolidated net income and consolidated ordinary

Table of Contents

shareholders' equity between amounts calculated under U.K. GAAP and those estimated under U.S. GAAP, you should read pages 91 and 182 -208 of the 2004 Form 20-F.

By Regulation, the European Union agreed that virtually all listed companies must use International Financial Reporting Standards **("IFRS")** adopted for use in the European Union in the preparation of their 2005 consolidated accounts. We will adopt the requirements of IFRS for the first time for the purpose of preparing financial statements for the year ending December 31, 2005.

The results of the six months to June 30, 2005 have been stated on an IFRS basis. For prior periods, the Group has applied IFRS from January 1, 2004, with the exception of the standards relating to financial instruments and insurance contracts, which are applied only with effect from January 1, 2005. The impacts of adopting IAS 32, IAS 39 and IFRS 4 are not included in the 2004 comparatives in accordance with IFRS 1 and financial instruments and insurance contracts are accounted for in accordance with UK GAAP in 2004. Therefore, the results for 2005 are not entirely comparable to those for 2004 in affected areas.

THE BARCLAYS BANK GROUP

Barclays Bank PLC and its subsidiary undertakings (taken together, the "Group") is a major global financial services provider engaged in retail and commercial banking, credit cards, investment banking, wealth management and investment management services. The Group also operates in many other countries around the world. The whole of the issued ordinary share capital of Barclays Bank PLC is beneficially owned by Barclays PLC, which is the ultimate holding company of the Group and one of the largest financial services companies in the world by market capitalization.

USE OF PROCEEDS

Unless otherwise indicated in the accompanying prospectus supplement, the net proceeds from the offering of the securities will be used to support the development and expansion of our business and/or to strengthen further our capital base. That development and expansion may occur through the development of existing operations, the establishment of new subsidiaries or acquisitions if suitable opportunities should arise.

Table of Contents

RATIOS OF EARNINGS TO FIXED CHARGES AND PREFERENCE SHARE DIVIDENDS AND OTHER APPROPRIATIONS

Ratios of Earnings to Fixed Charges

Our ratios of earnings to fixed charges for the five years ended December 31, 2004, using financial information calculated in accordance with U.K. GAAP and approximate financial information adjusted to reflect U.S. GAAP, were:

	Year ended December 31,				
	2004	2003	2002	2001	2000
U.K. GAAP					
Excluding interest on deposits	1.48	1.55	1.50	1.40	1.49
Including interest on deposits	1.32	1.35	1.31	1.26	1.29
U.S. GAAP					
Excluding interest on deposits	1.47	1.36	1.58	1.47	1.49
Including interest on deposits	1.31	1.23	1.36	1.30	1.29

For the purpose of calculating the ratios of earnings to fixed charges, earnings consist of: (1) income before taxes and minority interests plus fixed charges *less* (2) unremitted pre-tax loss/income of associated companies and joint ventures. Fixed charges consist of total interest expense, including or excluding interest on deposits, as appropriate, and the proportion of rental expense deemed representative of the interest factor.

Ratios of Earnings to Fixed Charges and Preference Share Dividends and Other Appropriations

Our ratios of earnings to fixed charges and preference share dividends and other appropriations for the five years ended December 31, 2004, using financial information calculated in accordance with U.K. GAAP and approximate financial information adjusted to reflect U.S. GAAP, were:

	Year ended December 31,				
	2004	2003	2002	2001	2000
U.K. GAAP					
Excluding interest on deposits	1.48	1.55	1.50	1.40	1.48
Including interest on deposits	1.32	1.35	1.31	1.26	1.29
U.S. GAAP					
Excluding interest on deposits	1.46	1.34	1.55	1.45	1.47
Including interest on deposits	1.31	1.22	1.35	1.29	1.28

For the purpose of calculating the ratios of earnings to fixed charges and preference share dividends and other appropriations, earnings consist of income before taxes, minority interests and extraordinary items, plus fixed charges and after deduction of the unremitted pre-tax income of associated companies. Fixed charges consist of total interest expense, including or excluding interest on deposits, as appropriate, and the proportion of rental expense deemed representative of the interest factor. Preference share dividends for the five years ended December 31, 2004 represent the amount of pre-tax earnings required to pay dividends on the following issues of the Bank's preference shares:

- Non-cumulative Dollar-denominated Preference Shares, Series C1 and Non-cumulative Dollar-denominated Non-voting Preference Shares, Series C2, issued (and offered and sold as units) in June 1990 and redeemed in June 2000;
- Non-cumulative Dollar-denominated Preference Shares, Series D1 and Non-cumulative Dollar-denominated Non-voting Preference Shares, Series D2 issued (and offered and sold as units) in March 1991 and redeemed in March 2001; and
- Euro-denominated 4.875 per cent. Non-Cumulative Callable Preference Shares, issued in December 2004.

Other appropriations represent amounts payable in respect of reserve capital instruments that the Bank issued in May 2000, September 2000 and June 2001.

Table of Contents

CAPITALIZATION AND INDEBTEDNESS

The following table sets out the authorized and issued share capital of the Barclays Bank PLC and the Group's total shareholders' equity, indebtedness and contingent liabilities as at June 30, 2005. The information has been prepared in accordance with the International Financial Reporting Standards (IFRS).

	As at June 30, 2005
	'000
Share capital of Barclays Bank PLC	
Authorized ordinary share capital — shares of £1 each	3,000,000
Authorized preference share capital— shares of £100 each	400
Authorized preference share capital — shares of £1 each	1
Authorized preference share capital — shares of U.S.$100 each	400
Authorized preference share capital — shares of U.S.$0.25 each	80,000
Authorized preference share capital — shares of €100 each	400
Ordinary shares — issued and fully paid shares of £1 each	2,311,361
Preference shares — issued and fully paid shares of £100 each	75
Preference shares — issued and fully paid shares of £1 each	1
Preference shares — issued and fully paid shares of US$100 each	100
Preference shares — issued and fully paid shares of US$0.25 each	—
Preference shares — issued and fully paid shares of €100 each	240
Group total shareholders' equity	***£ million***
Called up share capital	2,341
Share premium	8,786
Available for sale reserve	374
Cash flow hedging reserve	328
Other shareholders' funds	2,551
Translation reserve	(35)
Retained earnings	7,479
Shareholders' equity (excluding minority interests)	**21,824**
Minority interests	200
Total Shareholders' equity	**22,024**
Group indebtedness[(1)]	
Subordinated liabilities	
Undated loan capital — non-convertible	4,366
Dated loan capital — convertible to preference shares	13
Dated loan capital — non-convertible[(2)]	6,930
Debt securities in issue	93,328
Total indebtedness	**104,637**
Total capitalization and indebtedness	**126,661**
Group contingent liabilities	
Acceptances and endorsements	271
Assets pledged as collateral security	35,703
Other contingent liabilities	8,503
Total contingent liabilities	**44,477**

(1) "Group indebtedness" includes interest accrued as at June 30, 2005 in accordance with International Financial Reporting Standards.
(2) On September 9, 2005, we issued $500,000,000 Callable Floating Rate Subordinated Notes due 2017.

Table of Contents

DESCRIPTION OF DEBT SECURITIES

The following is a summary of the general terms of the debt securities. It sets forth possible terms and provisions for each series of debt securities. Each time that we offer debt securities, we will prepare and file a prospectus supplement with the Securities and Exchange Commission, which you should read carefully. The prospectus supplement may contain additional terms and provisions of those securities. If there is any inconsistency between the terms and provisions presented here and those in the prospectus supplement, those in the prospectus supplement will apply and will replace those presented here.

The debt securities of any series will be either our senior obligations (the "Senior Debt Securities") or our subordinated obligations (the "Subordinated Debt Securities"). Neither the Senior Debt Securities nor the Subordinated Debt Securities will be secured by any assets or property of Barclays Bank PLC. The Subordinated Debt Securities will either have a stated maturity (the "Dated Subordinated Debt Securities") or will not have a stated maturity (the "Undated Subordinated Debt Securities"). Some Undated Subordinated Debt Securities may be entirely or partially convertible into our preference shares, at our option.

We will issue Senior Debt Securities, Dated Subordinated Debt Securities and Undated Subordinated Debt Securities under indentures (respectively the "Senior Debt Indenture", "Dated Debt Indenture" and "Undated Debt Indenture") between us and The Bank of New York, as trustee. The terms of the debt securities include those stated in the relevant indenture, and those made part of the indenture by reference to the Trust Indenture Act. The Senior, Dated and Undated Debt Indentures are sometimes referred to in this prospectus individually as an "indenture" and collectively as the "indentures". We have filed a copy of, or the forms of, each indenture as exhibits to the registration statement, of which this prospectus is a part.

Because this section is a summary, it does not describe every aspect of the debt securities in detail. This summary is subject to, and qualified by reference to, all of the definitions and provisions of both the indentures and each series of debt securities. Certain terms, unless otherwise defined here, have the meaning given to them in the relevant indenture.

General

The debt securities are not deposits and are not insured by any regulatory body of the United States or the United Kingdom.

Because we are a holding company as well as an operating company, our rights to participate in the assets of any of our subsidiaries upon its liquidation will be subject to the prior claims of the subsidiaries' creditors, including, in the case of our bank subsidiaries, their respective depositors, except, in our case, to the extent that we may ourselves be a creditor with recognized claims against the relevant subsidiary.

The indentures do not limit the amount of debt securities that we may issue. We may issue the debt securities in one or more series, or as units comprised of two or more related series. The prospectus supplement will indicate for each series or of two or more related series of debt securities:

- whether the debt securities have a maturity date and if so, what that date is;
- the specific designation and aggregate principal amount of the debt securities;
- the prices at which we will issue the debt securities;
- if interest is payable, the interest rate or rates, or how to calculate the interest rate or rates;
- whether we will issue the Senior Debt Securities or Dated Subordinated Debt Securities as Discount Securities, as explained below, and the amount of the discount;
- provisions, if any, for the discharge and defeasance of Senior Debt Securities or Dated Subordinated Debt Securities of any series;
- any condition applicable to payment of any principal, premium or interest on Senior Debt Securities or Dated Subordinated Debt Securities of any series;
- the dates and places at which any payments are payable;

Table of Contents

- the terms of any mandatory or optional redemption;
- the denominations in which the debt securities will be issued, which may be an integral multiple of either $1,000, $25 or any other specified amount;
- the amount, or how to calculate the amount, that we will pay the Senior Debt Security holder or Dated Subordinated Debt Security holder, if the Senior Debt Security or Dated Subordinated Debt Security is redeemed before its stated maturity or accelerated, or for which the trustee shall be entitled to file and prove a claim;
- whether and how the debt securities may or must be converted into any other type of securities, or their cash value, or a combination of these;
- the currency or currencies in which the debt securities are denominated, and in which we make any payments;
- whether we will issue the debt securities wholly or partially as one or more global debt securities;
- what conditions must be satisfied before we will issue the debt securities in definitive form ("definitive debt securities");
- any index we will use to determine the amount of any payments on the debt securities;
- any other or different Senior Events of Default, in the case of Senior Debt Securities, or any other or different Subordinated Events of Default, Dated Debt Defaults or Undated Debt Defaults, in the case of Subordinated Debt Securities, or covenants applicable to any of the debt securities, and the relevant terms if they are different from the terms in the applicable indenture;
- any restrictions applicable to the offer, sale and delivery of the debt securities;
- if we will pay Additional Amounts, as explained below, on the debt securities;
- whether we will issue the debt securities in registered form ("registered securities") or in bearer form ("bearer securities") or both;
- whether and how bearer securities may be exchanged for registered securities;
- for registered securities, the record date for any payment of principal, interest or premium;
- any listing of the debt securities on a securities exchange;
- any other or different terms of the debt securities; and
- what we believe are any additional material United States federal and United Kingdom tax considerations.

Debt securities may bear interest at a fixed rate or a floating rate or we may sell Senior Debt Securities or Dated Subordinated Debt Securities that bear no interest or that bear interest at a rate below the prevailing market interest rate or at a discount to their stated principal amount ("Discount Securities"). The relevant prospectus supplement will describe special United States federal income tax considerations applicable to Discount Securities or to debt securities issued at par that are treated for United States federal income tax purposes as having been issued at a discount.

Holders of debt securities have no voting rights except as explained below under " – Modification and Waiver" and "Senior Events of Default; Subordinated Event of Default and Defaults; Limitation of Remedies".

Market-Making Transactions. If you purchase your debt security and/or any of our other securities we describe in this prospectus in a market-making transaction, you will receive information about the price you pay and your trade and settlement dates in a separate confirmation of sale. A market-making transaction is one in which Barclays Capital Inc. or another of our affiliates resells a security that it has previously acquired from another holder. A market-

Table of Contents

making transaction in a particular debt security occurs after the original issuance and sale of the debt security.

Legal Ownership; Form of Debt Securities

Street Name and Other Indirect Holders. Investors who hold debt securities in accounts at banks or brokers will generally not be recognized by us as legal holders of debt securities. This is called holding in street name.

Instead, we would recognize only the bank or broker, or the financial institution the bank or broker uses to hold its debt securities. These intermediary banks, brokers and other financial institutions pass along principal, interest and other payments on the debt securities, either because they agree to do so in their customer agreements or because they are legally required. An investor who holds debt securities in street name should check with the investor's own intermediary institution to find out:

- how it handles debt securities payments and notices;
- whether it imposes fees or charges;
- how it would handle voting if it were ever required;
- whether and how the investor can instruct it to send the investor's debt securities, registered in the investor's own name so the investor can be a direct holder as described below; and
- how it would pursue rights under the debt securities if there were a default or other event triggering the need for holders to act to protect their interests.

Direct Holders. Our obligations, as well as the obligations of the trustee and those of any third parties employed by us or the trustee, run only to persons who are registered as holders of debt securities. As noted above, we do not have obligations to an investor who holds in street name or other indirect means, either because the investor chooses to hold debt securities in that manner or because the debt securities are issued in the form of global securities as described below. For example, once we make payment to the registered holder, we have no further responsibility for the payment even if that holder is legally required to pass the payment along to the investor as a street name customer but does not do so.

Global Securities. A global security is a special type of indirectly held security, as described above under "Street Name and Other Indirect Holders". If we issue debt securities in the form of global securities, the ultimate beneficial owners can only be indirect holders.

We require that the global security be registered in the name of a financial institution we select. In addition, we require that the debt securities included in the global security not be transferred to the name of any other direct holder unless the special circumstances described below occur. The financial institution that acts as the sole direct holder of the global security is called the depositary. Any person wishing to own a security must do so indirectly by virtue of an account with a broker, bank or other financial institution that in turn has an account with the depositary. Unless the applicable prospectus supplement indicates otherwise, each series of debt securities will be issued only in the form of global securities.

Special Investor Considerations for Global Securities. As an indirect holder, an investor's rights relating to a global security will be governed by the account rules of the investor's financial institution and of the depositary, as well as general laws relating to securities transfers. We do not recognize this type of investor as a holder of debt securities and instead deal only with the depositary that holds the global security.

Investors in debt securities that are issued only in the form of global debt securities should be aware that:

- They cannot get debt securities registered in their own name.
- They cannot receive physical certificates for their interest in debt securities.
- They will be a street name holder and must look to their own bank or broker for payments on the debt securities and protection of their legal rights relating to the debt securities, as explained earlier under "Legal Ownership – Street Name and Other Indirect Holders".

Table of Contents

- They may not be able to sell interests in the debt securities to some insurance companies and other institutions that are required by law to own their debt securities in the form of physical certificates.
- The depositary's policies will govern payments, transfers, exchange and other matters relating to their interest in the global security. We and the trustee have no responsibility for any aspect of the depositary's actions or for its records of ownership interests in the global security. We and the trustee also do not supervise the depositary in any way.
- The depositary will require that interests in a global security be purchased or sold within its system using same-day funds.

Special Situations When a Global Security Will Be Terminated. In a few special situations described below, the global security will terminate and interests in it will be exchanged for physical certificates representing debt securities. After that exchange, the choice of whether to hold debt securities directly or in street name will be up to the investor. Investors must consult their own bank or brokers to find out how to have their interests in debt securities transferred to their own name so that they will be direct holders. The rights of street name investors and direct holders in the debt securities have been previously described in the subsections entitled "Legal Ownership – Street Name and Other Indirect Holders" and "Legal Ownership – Direct Holders".

The special situations for termination of a global security are:

- When the depositary notifies us that it is unwilling, unable or no longer qualified to continue as depositary.
- When a Senior Event of Default, in the case of Senior Debt Securities, or a Subordinated Event of Default, Dated Debt Default or Undated Debt Default, in the case of Subordinated Debt Securities, has occurred and has not been cured. Defaults are discussed below under "Senior Events of Default; Subordinated Event of Default and Defaults; Limitation of Remedies".

The prospectus supplement may also list additional situations for terminating a global security that would apply only to the particular series of debt securities covered by the prospectus supplement. When a global security terminates, the depositary (and not we or the trustee) is responsible for deciding the names of the institutions that will be the initial direct holders.

In the remainder of this description "holder" means direct holders and not street name or other indirect holders of debt securities. Indirect holders should read the subsection entitled "Legal Ownership – Street Name and Other Indirect Holders".

Payment and Paying Agents. We will pay interest to direct holders listed in the trustee's records at the close of business on a particular day in advance of each due date for interest, even if the direct holder no longer owns the security on the interest due date. That particular day, usually about two weeks in advance of the interest due date, is called the regular record date and is stated in the prospectus supplement.

We will pay interest, principal and any other money due on the debt securities at the corporate trust office of the trustee in New York City. Investors must make arrangements to have their payments picked up at or wired from that office. We may also choose to pay interest by mailing checks.

Street name and other indirect holders should consult their banks or brokers for information on how they will receive payments.

We may also arrange for additional payment offices, and may cancel or change these offices, including our use of the trustee's corporate trust office. These offices are called paying agents. We may also choose to act as our own paying agent. We must notify the trustee of changes in the paying agents for any particular series of debt securities.

Payments; Deferred Payments; Missed Payments

The relevant prospectus supplement will specify the date on which we will pay interest, if any, and, in the case of Senior Debt Securities or Dated Subordinated Debt Securities, the date for payments of principal and any premium, on any particular series of debt securities. The prospectus supplement will also specify the interest rate or rates, if any, or how rate or rates will be calculated.

Table of Contents

Dated Subordinated Debt Securities

Unless the relevant prospectus supplement provides otherwise, and subject also to the following paragraph, if we do not make a payment on a series of Dated Subordinated Debt Securities on any payment date, our obligation to make that payment shall be deferred (a "Deferred Payment"), until:

- if it is an interest payment, the date we pay a dividend on any class of our share capital, and
- if it is a payment of principal, the first business day after the date that falls six months after the original payment date.

Each of the above dates is a "deferred payment date". Our failure to make a payment before the deferred payment date is not a Dated Debt Default nor will it allow any holder to sue us or take any other action for the payment. Each Deferred Payment will accrue interest at the rate which prevailed for that series of Dated Subordinated Debt Securities immediately before the payment's original payment date. Any such Deferred Payment shall not be treated as due for any purpose, including for the purpose of determining whether a default has occurred, until the deferred payment date. The term "business day" means any weekday, other than one on which banking institutions are authorized or obligated by law or executive order to close in any jurisdiction where payments on the debt security are payable.

If we so provide in the relevant prospectus supplement and notwithstanding any other provision of the Dated Subordinated Debt Securities, we will be entitled, by notice in writing to the trustee (a "deferral notice"), to defer the due date for payment of any principal, premium or interest in respect of that series of Dated Subordinated Debt Securities when the Financial Services Authority has requested or required us to make that deferral. Accordingly, on providing a deferral notice, the payment due date of the principal, premium or interest (the "Tier 3 Deferred Payment") shall be deferred. As a result, we will not have to make that payment on the date that it would otherwise have become due and payable.

Interest will continue to accrue on the deferred principal at the rate prevailing immediately before the due date of that principal amount, unless the relevant prospectus supplement otherwise specifies. This interest, however, shall only become due and payable according to the following sentence. Promptly upon being satisfied that the Financial Services Authority will not object to our payment of the whole or any part of any Tier 3 Deferred Payment, and, unless the payment was deferred as described in the first paragraph under this section "Dated Subordinated Debt Securities", we will give notice to the trustee in writing. The relevant Tier 3 Deferred Payment, or the appropriate part of it, and any accrued interest shall become due and payable on the seventh day after the date of the payment notice, the "Tier 3 Deferred Payment Date". In addition, if a Subordinated Event of Default occurs all unpaid Tier 3 Deferred Payments in respect of Dated Subordinated Debt Securities of a series shall become due and payable in full upon acceleration of payment of the Dated Subordinated Debt Securities of that relevant series. In case of acceleration, if more than one Tier 3 Deferred Payment remains unpaid in respect of Dated Subordinated Debt Securities of any series, payment shall be made pro rata according to the amounts of the unpaid Tier 3 Deferred Payments and the interest accrued at the time a Subordinated Event of Default has occurred.

Our failure to make any payment prior to a Tier 3 Deferred Payment Date to the extent permitted by the provisions we have just described shall not constitute a Dated Debt Default by us or otherwise allow any holder to sue or take any action for that payment. Any Tier 3 Deferred Payment deferred according to these provisions shall not be treated as due for any purpose, including for the purpose of ascertaining whether a Dated Debt Default has occurred, until the Tier 3 Deferred Payment Date.

We are currently obliged to notify the U.K. Financial Services Authority (the "Financial Services Authority") if our capital for regulatory capital adequacy purposes falls below its target capital requirement, as set by the Financial Services Authority. The Financial Services Authority may require deferral of payment of principal and interest on Dated Subordinated Debt Securities in that case.

Undated Subordinated Debt Securities

We are not required to make payments on any series of Undated Subordinated Debt Securities on any payment date except as we discuss in the following paragraph. Our failure to make a payment (unless the

Table of Contents

payment is required as we describe in the following two paragraphs) shall not constitute an Undated Debt Default by us for any purpose. Any payment that we do not make in respect of any series of Undated Subordinated Debt Securities on any applicable payment date, together with any other unpaid payments, shall, so long as they remain unpaid, constitute "Missed Payments". Missed Payments will accumulate until paid, but will not bear interest.

We may choose to pay any Missed Payments in whole or in part at any time on not less than 14 days' notice to the trustee. However, all outstanding Missed Payments in respect of all Undated Subordinated Debt Securities of a particular series shall, subject to the solvency condition as explained below, become due and payable in full on whichever is the earlier of:

- the date on which a dividend is next paid on any class of share capital of Barclays PLC, or any other ultimate holding company of us, or if there is no holding company, ourselves, or on any class of our preference share capital,
- the date fixed for any redemption of the Undated Subordinated Debt Securities, and
- the commencement of our winding-up in England.

If we give notice of our intention to pay the whole or part of the Missed Payments on the Undated Subordinated Debt Securities of any series, we shall be obliged, subject to the solvency condition, to do so at the time specified in our notice. When Missed Payments in respect of Undated Subordinated Debt Securities of any series are paid in part, each part payment shall be in respect of the full amount of Missed Payments accrued on the payment date or consecutive payment dates furthest from the date of payment.

All payments of principal, premium and interest, including any Missed Payments, on or with respect to the Undated Subordinated Debt Securities of any series will be conditional upon our being solvent at the time of our payment, and remaining solvent immediately after our payment. This is called the "solvency condition". The solvency condition must also be satisfied when, and immediately after, we or any of our subsidiaries repurchase Undated Subordinated Debt Securities, except a purchase in the ordinary course of a business dealing in securities. For the purposes of the solvency condition, we shall be solvent if

- we are able to pay our debts as they fall due and
- our total unconsolidated gross tangible assets exceed our total unconsolidated gross liabilities, subject to certain adjustments specified in the indenture; provided, that as to any event conditional on the solvency condition other than an optional redemption or repurchase, liabilities shall exclude those to persons who are not Undated Debt Senior Creditors (as defined below).

A report as to our solvency by one Director or a senior executive or, in certain circumstances as provided in the indenture, our Auditors, or, if we are in winding-up in England, our liquidator, shall, absent proven error, be treated and accepted by us, the trustee and the holders of Undated Subordinated Debt Securities and the Coupons (if any) appertaining thereto, as correct and sufficient evidence of solvency or insolvency.

If we are unable to make any payment on or with respect to the Undated Subordinated Debt Securities of any series because we are unable to satisfy the solvency condition, the amount of any such payment which we would otherwise make will be available to meet our losses. If we are wound-up, applicable insolvency law may limit the right to claim for any amount payable, including interest and Missed Payments, on the Undated Subordinated Debt Securities.

Ranking

Senior Debt Securities. Senior Debt Securities and the Coupons (if any) appertaining thereto constitute our direct, unconditional, unsecured and unsubordinated obligations ranking pari passu, without any preference among themselves, with all our other outstanding unsecured and unsubordinated obligations, present and future, except such obligations as are preferred by operation of law.

Dated Subordinated Debt Securities. In the event of our winding-up in England (liquidation), the claims of the trustee, the holders of the Dated Subordinated Debt Securities and the holders of the Coupons (if any)

Table of Contents

appertaining thereto, will be postponed to the claims of all of our other creditors, including any claims related to the Senior Debt Securities, except for:

- claims in respect of Existing Senior Subordinated Obligations, Capital Note Claims and Subordinated Guarantee Claims (each as defined in the Dated Debt Indenture) and any other claims ranking or expressed to rank equally with them and/or with claims in respect of the Dated Subordinated Debt Securities ("Dated Debt Other Pari Passu Claims"); and
- any other claims ranking junior to the excepted claims referred to above and/or to claims in respect of Dated Subordinated Debt Securities.

The claims of such other creditors, with the foregoing exceptions, are referred to in this document as "Dated Debt Senior Claims". Accordingly, no amount will be payable in our winding-up in respect of claims in relation to the Dated Subordinated Debt Securities or the Coupons (if any) appertaining thereto until all Dated Debt Senior Claims admitted in our winding-up have been satisfied.

Any amounts in respect of the Dated Subordinated Debt Securities and the Coupons (if any) appertaining thereto paid to the holders of such Dated Subordinated Debt Securities, the holders of the Coupons appertaining thereto (if any) or to the trustee pari passu with the amounts payable to other creditors admitted in such winding up will be held by such holders or the trustee upon trust to be applied in the following order: (i) to the amounts due to the trustee in or about the execution of the trusts of the Dated Debt Indenture; (ii) in payment of all Dated Debt Senior Claims outstanding at the commencement of, or arising solely by virtue of, our winding up to the extent that such claims shall be admitted in the winding up and shall not be satisfied out of our other resources; and (iii) in payment of the Dated Subordinated Debt Securities and the Coupons (if any) appertaining thereto. By accepting the Dated Subordinated Debt Securities or the Coupons (if any) appertaining thereto, each holder agrees to be bound by the Dated Debt Indenture's subordination provisions and irrevocably authorizes our liquidator to perform on behalf of the holder the above subordination trust.

Because of subordination, in the event of our winding-up in England, our creditors who hold Dated Debt Senior Claims may recover more, ratably, than the holders of the Dated Subordinated Debt Securities or the Coupons (if any) appertaining thereto and Dated Debt Other Pari Passu Claims. At June 30, 2005 the amount of outstanding Dated Debt Senior Claims was approximately £697,889 million (including £262,090 million of deposits and £66,242 million of debt securities in issue). Currently we have no limitations on issuing indebtedness which would constitute Dated Debt Senior Claims.

At June 30, 2005, Dated Debt Other Pari Passu Claims were approximately £7,151 million, consisting of debt securities we issued, our guarantees in respect of outstanding debt securities issued by our subsidiaries and intra-group loans to us. The amounts of all securities, guarantees or intra-group loans denominated in a currency other than pounds sterling included in the above totals have been converted at the exchange rates prevailing on June 30, 2005.

Undated Subordinated Debt Securities. The Undated Subordinated Debt Securities of each series will be our unsecured obligations, subject to the solvency condition and the subordination provisions described here. They will rank equally without any preference among themselves and will also rank equally as to subordination with our Undated Debt Other Pari Passu Claims (as defined in the Undated Debt Indenture).

The rights of the trustee and the holders of Undated Subordinated Debt Securities and the Coupons (if any) appertaining thereto will be subordinated to the claims of our creditors:

- who are our depositors and/or other unsubordinated creditors, or
- whose claims are, or are expressed to be, subordinated to the claims of depositors and other unsubordinated creditors (whether only in our winding up or otherwise) but not to other claims, or
- who are subordinated creditors (whether as above or otherwise) other than creditors whose claims constitute Undated Debt Other Pari Passu Claims and creditors whose claims are expressed to rank pari passu with

Table of Contents

or junior to the claims of the holders of the Undated Subordinated Debt Securities.

These creditors, with the foregoing exceptions, are referred to in this document as "Undated Debt Senior Creditors" and the claims of Undated Debt Senior Creditors are referred to in this document as "Undated Debt Senior Claims". In the event of our winding-up in England (liquidation) there shall be payable in respect of the Undated Subordinated Debt Securities and the Coupons (if any) appertaining thereto, in lieu of any other payment but subject to the solvency condition, those amounts (if any) as would have been payable as if on the day immediately before the commencement of our winding-up and thereafter, the holders of Undated Subordinated Debt Securities were the holders of a class of preference shares in our capital having a preferential right to a return of assets over the holders of all other classes of shares in our capital issued and outstanding. As a result the holders of the Undated Subordinated Debt Securities would therefore be treated as entitled, to the exclusion of any other rights or privileges, to receive as a return of capital in the winding-up an amount equal to the principal amount of the Undated Subordinated Debt Securities then outstanding, together with any premium and interest accrued to the date of repayment and any Missed Payments. Accordingly, no amount will be payable in our winding-up in England in respect of claims under any Undated Subordinated Debt Securities and the Coupons (if any) appertaining thereto, until all Undated Debt Senior Claims admitted in such winding-up have been satisfied.

Because of the subordination, in the event of our winding-up in England, holders of Undated Debt Senior Claims may recover more, ratably, than holders of the Undated Subordinated Debt Securities, the Coupons (if any) appertaining thereto and Undated Debt Other Pari Passu Claims. In this context, the claims of holders of any Senior Debt Securities, Dated Subordinated Debt Securities then outstanding, the Coupons (if any) appertaining thereto and Dated Debt Other Pari Passu Claims then outstanding, would be included in Undated Debt Senior Claims.

On June 30, 2005, the amount of outstanding Undated Debt Senior Claims was approximately £704,921 million (including £262,090 million of deposits and £66,242 million of debt securities in issue). On June 30, 2005, an aggregate of approximately £3,583 million of Undated Debt Other Pari Passu Claims were outstanding. Currently there is no limitation on our issuing indebtedness which would constitute Undated Debt Senior Claims. If, in our winding-up, the amounts payable with respect to the Undated Subordinated Debt Securities and any Undated Debt Other Pari Passu Claims are not paid in full, the holders will share ratably in any distribution of our assets in proportion to the respective amounts to which they are entitled.

Additional Amounts

Unless the relevant prospectus supplement provides otherwise, we will pay any amounts to be paid by us on any series of debt securities without deduction or withholding for, or on account of, any and all present or future income, stamp and other taxes, levies, imposts, duties, charges, fees, deductions or withholdings ("taxes") now or hereafter imposed, levied, collected, withheld or assessed by or on behalf of the U.K. or any U.K. political subdivision or authority that has the power to tax, unless the deduction or withholding is required by law. Unless the relevant prospectus supplement provides otherwise, at any time a U.K. taxing jurisdiction requires us to deduct or withhold taxes, we will pay the additional amounts of, or in respect of, the principal of, any premium, and any interest, Deferred Payments, Tier 3 Deferred Payments and Missed Payments on the debt securities ("Additional Amounts") that are necessary so that the net amounts paid to the holders, after the deduction or withholding, shall equal the amounts which would have been payable had no such deduction or withholding been required. However, we will not pay Additional Amounts for taxes that are payable because:

- the holder or the beneficial owner of the debt securities is a domiciliary, national or resident of, or engages in business or maintains a permanent establishment or is physically present in, a U.K. taxing jurisdiction requiring that deduction or withholding, or otherwise has some connection with the U.K. taxing jurisdiction other than the holding or ownership of the debt security, or the collection of any payment of, or in respect of, principal of, any premium, or any interest, Deferred Payments, Tier 3 Deferred Payments and

Table of Contents

Missed Payments on, any debt securities of the relevant series;

- except in the case of our winding-up in England, the relevant debt security is presented for payment in the U.K.;
- the relevant debt security is presented for payment more than 30 days after the date payment became due or was provided for, whichever is later, except to the extent that the holder would have been entitled to the Additional Amounts on presenting the debt security for payment at the close of such 30-day period;
- such deduction or withholding is imposed on a payment to an individual and is required to be made pursuant to the European Union directive on the taxation of savings adopted by the council of the European Union on June 3, 2003;
- the relevant debt security is presented for payment by a holder who would have been able to avoid such deduction or withholding by presenting the relevant debt security to another paying agent in a member state of the European Union or elsewhere;
- the holder or the beneficial owner of the relevant debt securities or the beneficial owner of any payment of, or in respect of, principal of, any premium, or any interest, Deferred Payments, Tier 3 Deferred Payments or Missed Payments on the debt securities failed to make any necessary claim or to comply with any certification, identification or other requirements concerning the nationality, residence, identity or connection with the taxing jurisdiction of the holder or beneficial owner, if that claim or compliance is required by statute, treaty, regulation or administrative practice of a U.K. taxing jurisdiction as a condition to relief or exemption from the taxes; or
- if the taxes would not have been imposed or would have been excluded under one of the preceding points if the beneficial owner of, or person ultimately entitled to obtain an interest in, the debt securities had been the holder of the debt securities.

Whenever we refer in this prospectus and any prospectus supplement to the payment of the principal of, any premium, or any interest, Deferred Payments, Tier 3 Deferred Payments or Missed Payments, if any, on, or in respect of, any debt securities of any series, we mean to include the payment of Additional Amounts to the extent that, in context, Additional Amounts are, were or would be payable.

Redemption

Redemption or Conversion for tax reasons. Unless the relevant prospectus supplement provides otherwise, and, in the case of Undated Subordinated Debt Securities, if the solvency condition is satisfied, we will have the option to redeem the debt securities of any series upon not less than 30 nor more than 60 days' notice on any dates as are specified in the applicable prospectus supplement, and we will have the option of converting any Undated Subordinated Debt Securities that are convertible into preference shares, if:

- we are required to issue definitive debt securities (see "Legal Ownership-Special Situations When a Global Security Will Be Terminated") and, as a result, we are or would be required to pay Additional Amounts with respect to the debt securities, or
- we determine that as a result of a change in or amendment to the laws or regulations of a taxing jurisdiction, including any treaty to which the taxing jurisdiction is a party, or a change in an official application or interpretation of those laws or regulations, including a decision of any court or tribunal, which becomes effective on or after the date of the applicable prospectus supplement (and, in the case of a successor entity, which becomes effective on or after the date of that entity's assumption of our obligations), we (or any successor entity) will or would be required to pay holders Additional Amounts, or we (or any successor entity) would not be entitled to claim a deduction in respect of any payments in computing our (or its) taxation liabilities.

In each case, before we give a notice of redemption or conversion, we shall be required to deliver to the

Table of Contents

trustee a written legal opinion of independent counsel of recognized standing, chosen by us, in a form satisfactory to the trustee confirming that we are entitled to exercise our right of redemption or conversion. The redemption or conversion must be made in respect of all, but not some, of the debt securities of the relevant series. The redemption price will be equal to 100% of the principal amount of debt securities being redeemed together with any accrued but unpaid interest, Deferred Payments, Tier 3 Deferred Payments and Missed Payments, if any, in respect of such debt securities to the date fixed for redemption or, in the case of Discount Securities, such portion of the principal amount of such Discount Securities as may be specified by their terms.

Optional Redemption. The relevant prospectus supplement will specify whether we may redeem the debt securities of any series, in whole or in part, at our option, in any other circumstances. The prospectus supplement will also specify the notice we will be required to give, what prices and any premium we will pay, and the dates on which we may redeem the debt securities. Any notice of redemption of debt securities will state:

- the date fixed for redemption,
- the amount of debt securities to be redeemed if we are only redeeming a part of the series,
- the redemption price,
- that on the date fixed for redemption the redemption price will become due and payable on each debt security to be redeemed and, if applicable, that any interest will cease to accrue on or after the redemption date,
- the place or places at which each holder may obtain payment of the redemption price and
- the CUSIP number or numbers, if any, with respect to the debt securities.

In the case of a partial redemption, the trustee shall select the debt securities that we will redeem in any manner it deems fair and appropriate.

We or any of our subsidiaries may at any time purchase debt securities of any series in the open market or by tender (available alike to each holder of debt securities of the relevant series) or by private agreement, if applicable law allows, and, in the case of Undated Subordinated Debt Securities, if the solvency condition is satisfied. We will treat as cancelled and no longer issued and outstanding any debt securities of any series that we purchase beneficially for our own account, other than a purchase in the ordinary course of a business dealing in securities.

We may not redeem at our option any Dated Subordinated Debt Securities nor may we or any of our subsidiaries purchase beneficially or procure others to purchase beneficially for our accounts any Dated Subordinated Debt Securities, other than a purchase in the ordinary course of a business dealing in securities, unless our Auditors shall have reported to the trustee within six months before such redemption or purchase that, in their opinion, based on the most recent published consolidated balance sheet of us and our Subsidiary Undertakings, as defined in the indenture, available at the date of our report, the aggregate book value of the tangible assets of us and our Subsidiary Undertakings exceeds the aggregate book value of the liabilities of us and our Subsidiary Undertakings. We may not redeem any Undated Subordinated Debt Securities unless the solvency condition is satisfied.

In addition, under existing Financial Services Authority requirements, we may not make any redemption or repurchase of any Subordinated Debt Securities, other than a repurchase in the ordinary course of a business dealing in securities, unless the Financial Services Authority consents in advance. The Financial Services Authority may also impose conditions on any redemption or repurchase.

Convertible or Exchangeable Securities

Debt securities that are optionally or mandatorily convertible into preference shares or other of our securities, an index or indices of these securities or any combination of the above are called “convertible securities”. Debt securities that are optionally or mandatorily exchangeable for stock or other securities of another entity or entities, a basket or baskets of these securities, an index or indices of these securities or any combination of the above are called “exchangeable securities”.

Unless the applicable prospectus supplement specifies otherwise, optionally convertible or

Table of Contents

exchangeable securities will entitle the holder, during a period, or at specific times, to convert or exchange optionally convertible or exchangeable securities into or for the underlying security, basket or baskets of securities, index or indices of securities, or combination of these, at a specified rate of exchange. Optionally convertible or exchangeable securities will be redeemable at our option prior to maturity, if the applicable prospectus supplement so states. If a holder does not elect to convert or exchange the optionally convertible or exchangeable securities before maturity or any applicable redemption date, the holder will receive the principal amount of the optionally convertible or exchangeable securities.

Unless the applicable prospectus supplement specifies otherwise, the holder is not entitled to convert or exchange mandatorily convertible or exchangeable securities before maturity. At maturity, the holder must convert or exchange the mandatorily convertible or exchangeable securities for the underlying security, basket or baskets of securities or index or indices of securities, or a combination of these, at a specified rate of exchange, and, therefore, the holder may receive less than the principal amount of the mandatorily convertible or exchangeable security. If the applicable prospectus supplement so indicates, the specified rate at which a mandatorily convertible or exchangeable security will be converted or exchanged may vary depending on the value of the underlying securities, basket or baskets of securities, index or indices of securities, or combination of these so that, upon conversion or exchange, the holder participates in a percentage, which may be other than 100%, of the change in value of the underlying securities, basket or baskets, index or indices of securities, or combination of these.

Upon conversion or exchange, at maturity or otherwise, the holder of a convertible or exchangeable security may receive, at the specified exchange rate, either the underlying security or the securities constituting the relevant basket or baskets, index or indices, or combination of these, or the cash value thereof, as the applicable prospectus supplement may specify.

In addition, subject to certain conditions specified in the applicable prospectus supplement and unless it specifies otherwise, we may choose to convert all but not part of the Undated Subordinated Debt Securities into preference shares, on any payment date. You should refer to the applicable prospectus supplement for a description of the terms and conditions of this conversion.

Modification and Waiver

We and the trustee may make certain modifications and amendments to the indenture applicable to each series of debt securities without the consent of the holders of the debt securities. We may make other modifications and amendments with the consent of the holder(s) of not less than, in the case of the Senior Debt Securities, a majority of or, in the case of the Subordinated Debt Securities, 66 2/3% in aggregate principal amount of the debt securities of the series outstanding under the applicable indenture that are affected by the modification or amendment. However, we may not make any modification or amendment without the consent of the holder of each affected debt security that would:

- change the terms of any debt security to include, in the case of an Undated Subordinated Debt Security, a maturity date of its principal amount, or in the case of any other debt security, change the stated maturity date of its principal amount;
- reduce the principal amount of, or any premium, or interest, Deferred Payments, Tier 3 Deferred Payments or Missed Payments, with respect to any debt security;
- reduce the amount of principal on a Discount Security that would be due and payable upon an acceleration of the maturity date of any series of Senior Debt Securities or Dated Subordinated Debt Securities;
- change our obligation, or any successor's, to pay Additional Amounts;
- change the places at which payments are payable or the currency of payment;
- impair the right to sue for the enforcement of any payment due and payable;
- reduce the percentage in aggregate principal amount of outstanding debt securities of the series necessary to modify or amend the indenture or to waive compliance with

Table of Contents

certain provisions of the indenture and any past Senior Event of Default, Subordinated Event of Default, Dated Debt Default or Undated Debt Default (in each case as defined below);

- change our obligation to maintain an office or agency in the place and for the purposes specified in the indenture;
- change the terms and conditions of the preference shares or other securities into which the Undated Subordinated Debt Securities may be converted;
- modify the subordination provisions, if any, or the terms and conditions of our obligations in respect of the due and punctual payment of the amounts due and payable on the debt securities, in either case in a manner adverse to the holders; or
- modify the foregoing requirements or the provisions of the indenture relating to the waiver of any past Senior Event of Default, Subordinated Event of Default, Dated Debt Default or Undated Debt Default or covenants, except as otherwise specified.

In addition, material variations in the terms and conditions of Subordinated Debt Securities of any series, including modifications relating to the subordination, if any, of such debt securities, redemption, Subordinated Events of Default, Dated Debt Defaults or Undated Debt Defaults, may require the consent of the Financial Services Authority.

Senior Events of Default; Subordinated Event of Default and Defaults; Limitation of Remedies

Senior Events of Default

Unless the relevant prospectus supplement provides otherwise, a “Senior Event of Default” with respect to any series of Senior Debt Securities shall result if:

- we do not pay any principal or interest on any Senior Debt Securities of that series within 14 days from the due date for payment and the principal or interest has not been duly paid within a further 14 days following written notice from the trustee or from holders of 25% in principal amount of the Senior Debt Securities of that series to us requiring the payment to be made. It shall not, however, be a Senior Event of Default if during the 14 days after the notice we satisfy the trustee that such sums (“Withheld Amounts”) were not paid in order to comply with a law, regulation or order of any court of competent jurisdiction. Where there is doubt as to the validity or applicability of any such law, regulation or order, it shall not be a Senior Event of Default if we act on the advice given to us during the 14 day period by independent legal advisers approved by the trustee; or
- we breach any covenant or warranty of the Senior Debt Indenture (other than as stated above with respect to payments when due) and that breach has not been remedied within 21 days of receipt of a written notice from the trustee certifying that in its opinion the breach is materially prejudicial to the interests of the holders of the Senior Debt Securities of that series and requiring the breach to be remedied or from holders of at least 25% in principal amount of the Senior Debt Securities of that series requiring the breach to be remedied; or
- either a court of competent jurisdiction issues an order which is not successfully appealed within 30 days, or an effective shareholders’ resolution is validly adopted, for our winding-up (other than under or in connection with a scheme of reconstruction, merger or amalgamation not involving bankruptcy or insolvency).

If a Senior Event of Default occurs and is continuing, the trustee or the holders of at least 25% in outstanding principal amount of the Senior Debt Securities of that series may at their discretion declare the Senior Debt Securities of that series to be due and repayable immediately (and the Senior Debt Securities of that series shall thereby become due and repayable) at their outstanding principal amount (or at such other repayment amount as may be specified in or determined in accordance with the relevant prospectus supplement) together with accrued interest, if any, as provided in the prospectus

Table of Contents

supplement. The trustee may at its discretion and without further notice institute such proceedings as it may think suitable, against us to enforce payment. Subject to the indenture provisions for the indemnification of the trustee, the holder(s) of a majority in aggregate principal amount of the outstanding Senior Debt Securities of any series shall have the right to direct the time, method and place of conducting any proceeding in the name of and on the behalf of the trustee for any remedy available to the trustee or exercising any trust or power conferred on the trustee with respect to the series. However, this direction must not be in conflict with any rule of law or the Senior Debt Indenture, and must not be unjustly prejudicial to the holder(s) of any Senior Debt Securities of that series not taking part in the direction, as determined by the trustee. The trustee may also take any other action, consistent with the direction, that it deems proper.

If lawful, Withheld Amounts or a sum equal to Withheld Amounts shall be placed promptly on interest bearing deposit as described in the Senior Debt Indenture. We will give notice if at any time it is lawful to pay any Withheld Amount to holders of Senior Debt Securities or holders of Coupons or if such payment is possible as soon as any doubt as to the validity or applicability of the law, regulation or order is resolved. The notice will give the date on which the Withheld Amount and the interest accrued on it will be paid. This date will be the earliest day after the day on which it is decided Withheld Amounts can be paid on which the interest bearing deposit falls due for repayment or may be repaid without penalty. On such date, we shall be bound to pay the Withheld Amount together with interest accrued on it. For the purposes of this subsection this date will be the due date for those sums. Our obligations under this paragraph are in lieu of any other remedy against us in respect of Withheld Amounts. Payment will be subject to applicable laws, regulations or court orders, but in the case of payment of any Withheld Amount, without prejudice to the provisions described under " – Additional Amounts". Interest accrued on any Withheld Amount will be paid net of any taxes required by applicable law to be withheld or deducted and we shall not be obliged to pay any Additional Amount in respect of any such withholding or deduction.

The holder(s) of a majority of the aggregate principal amount of the outstanding Senior Debt Securities of any affected series may waive any past Senior Event of Default with respect to the series, except any default in respect of either:

- the payment of principal of, or any premium, or interest, on any Senior Debt Securities, or
- a covenant or provision of the relevant indenture which cannot be modified or amended without the consent of each holder of Senior Debt Securities of the series.

Subject to exceptions, the trustee may, without the consent of the holders, waive or authorize a Senior Event of Default if, in the opinion of the trustee, that Senior Event of Default would not be materially prejudicial to the interests of the holders.

The trustee will, within 90 days of a default with respect to the Senior Debt Securities of any series, give to each affected holder of the Senior Debt Securities of the affected series notice of any default it knows about, unless the default has been cured or waived. However, except in the case of a default in the payment of the principal of, or premium, if any, or interest, if any, on the Senior Debt Securities, the trustee will be entitled to withhold notice if the board of directors, the executive committee or a trust committee of directors or responsible officers of the trustee determine in good faith that withholding of notice is in the interest of the holder(s).

We are required to furnish to the trustee annually a statement as to our compliance with all conditions and covenants under the Senior Debt Indenture.

Notwithstanding any contrary provisions, nothing shall impair the right of a holder, absent the holder's consent, to sue for any payments due but unpaid with respect to the Senior Debt Securities.

Street name and other indirect holders should consult their banks or brokers for information on how to give notice or direction to or make a request of the trustee and how to waive a Senior Event of Default.

Subordinated Event of Default

If either a court of competent jurisdiction issues an order which is not successfully appealed within 30 days, or an effective shareholders' resolution is validly adopted, for our winding-up, other than under

Table of Contents

or in connection with a scheme of amalgamation, merger or reconstruction not involving a bankruptcy or insolvency, that order or resolution will constitute a "Subordinated Event of Default" with respect to all of the Subordinated Debt Securities. If a Subordinated Event of Default occurs and is continuing, the trustee or the holder(s) of at least 25% in aggregate principal amount of the outstanding Subordinated Debt Securities of each series may declare any accrued but unpaid payments, or, in the case of Discount Securities, the portion of principal amount specified in its terms, on the debt securities of the series to be due and payable immediately. However, after this declaration but before the trustee obtains a judgment or decree for payment of money due, the holder(s) of a majority in aggregate principal amount of the outstanding Subordinated Debt Securities of the series may rescind the declaration of acceleration and its consequences, but only if the Subordinated Event of Default has been cured or waived and all payments due, other than those due as a result of acceleration, have been made.

Dated Debt Defaults. Unless the relevant prospectus supplement provides otherwise, a "Dated Debt Default" with respect to any series of Dated Subordinated Debt Securities shall result if we do not pay any installment of interest upon, or any part of the principal of, and any premium on, any Dated Subordinated Debt Securities of that series on the date on which the payment is due and payable, whether upon redemption or otherwise, and the failure continues for 14 days in the case of interest and seven days in the case of principal. Current Financial Services Authority regulations do not permit us to provide for any additional events of default with respect to Dated Subordinated Debt Securities.

If a Dated Debt Default occurs and is continuing, the trustee may pursue all legal remedies available to it, including the institution of proceedings for our winding-up in England (but not elsewhere), but the trustee may not declare the principal amount of any outstanding Dated Subordinated Debt Securities due and payable. However, failure to make any payment in respect of a series of Dated Subordinated Debt Securities shall not be a Dated Debt Default if the payment is withheld or refused either:

- in order to comply with any fiscal or other law or regulation or with the order of any court of competent jurisdiction, or
- in case of doubt as to the validity or applicability of any such law, regulation or order, in accordance with advice given as to such validity or applicability at any time before the expiry of the 14 day period in the case of payment of interest or 7 day period in the case of payment of principal by independent legal advisers acceptable to the trustee.

In the second case, however, the trustee may, by notice to us, require us to take action, including proceedings for a court declaration, to resolve the doubt, if counsel advises it that the action is appropriate and reasonable. In this situation we will take the action promptly and be bound by any final resolution of the doubt. If the action results in a determination that we can make the relevant payment without violating any law, regulation or order then the payment shall become due and payable on the expiration of the 14 day period in the case of payment of interest or seven day period in the case of payment of principal after the trustee gives us written notice informing us of the determination.

By accepting a Dated Subordinated Debt Security each holder and the trustee will be deemed to have waived any right of set-off or counterclaim that they might otherwise have against us. No holder of Dated Subordinated Debt Securities shall be entitled to proceed directly against us unless the trustee has become bound to proceed but fails to do so within a reasonable period and the failure is continuing.

Undated Debt Defaults. Unless the relevant prospectus supplement provides otherwise, an Undated Debt Default shall result if, with respect to any series of Undated Subordinated Debt Securities, we fail to pay:

- any Missed Payments on or prior to any date upon which a dividend is next paid on any class of share capital of Barclays PLC, or any other ultimate holding company of us, or if there is no holding company, ourselves, or on any class of our preference share capital, and this failure continues for 30 days, or
- the principal amount and any premium, or any accrued but unpaid interest and any Missed Payments on the date fixed for

Table of Contents

redemption of such Undated Subordinated Debt Securities and this failure continues for seven business days.

If any Undated Debt Default occurs and is continuing, the trustee may pursue all legal remedies available to it, including the institution of proceedings for our winding-up in England (but not elsewhere), but the trustee may not declare the principal amount of any outstanding Undated Subordinated Debt Securities due and payable. For the purposes of determining whether an Undated Debt Default has occurred, a payment shall not be deemed to be due on any date on which the solvency condition is not satisfied, but this does not apply in regard to proceedings by the trustee for our winding-up in England. However, the trustee may not commence proceedings for our winding-up in England for failure to make any payment in respect of a series of Undated Subordinated Debt Securities if the payment is withheld or refused either:

- in order to comply with any fiscal or other law or regulation or with the order of any court of jurisdiction, or
- in case of doubt as to the validity or applicability of any such law, regulation or order, in accordance with advice given as to such validity or applicability at any time before the expiry of the 30-day or seven business day period, as applicable, by independent legal advisers acceptable to the trustee.

In the second case, however, the trustee may, by notice to us, require us to take action, including proceedings for a court declaration, to resolve the doubt, if counsel advises it that the action is appropriate and reasonable. In this case we shall proceed with the action promptly and be bound by any final resolution of the doubt. If the action results in a determination that we can make the relevant payment without violating any law, regulation or order then the payment shall become due and payable on the expiration of the 30-day or seven business day period, as applicable, after the trustee gives us written notice informing us of the determination.

By accepting an Undated Subordinated Debt Security, each holder and the trustee will be deemed to have waived any right of set-off or counterclaim that they might otherwise have against us with respect to the Undated Subordinated Debt Security or the applicable indenture. No holder of Undated Subordinated Debt Securities shall be entitled to proceed directly against us unless the trustee has become bound to proceed but fails to do so within a reasonable period, and the failure is continuing.

Waiver; Trustee's Duties – Subordinated Debt Securities. The holder(s) of not less than a majority in aggregate principal amount of the debt securities of any affected series may waive any past Subordinated Event of Default, Dated Debt Default or Undated Debt Default with respect to the series, except any default in respect of either:

- the payment of principal of, or any premium, or interest, Deferred Payments, Tier 3 Deferred Payments or Missed Payments on any Subordinated Debt Securities, or
- a covenant or provision of the relevant indenture which cannot be modified or amended without the consent of each holder of Subordinated Debt Securities of the series.

Subject to the applicable indenture provisions regarding the trustee's duties, in case a Subordinated Event of Default, Dated Debt Default or Undated Debt Default occurs and is continuing with respect to the debt securities of any series, the trustee will have no obligation to any holder(s) of the Subordinated Debt Securities of that series, unless they have offered the trustee reasonable indemnity. Subject to the indenture provisions for the indemnification of the trustee, the holder(s) of a majority in aggregate principal amount of the outstanding Subordinated Debt Securities of any series shall have the right to direct the time, method and place of conducting any proceeding in the name of and on the behalf of the trustee for any remedy available to the trustee or exercising any trust or power conferred on the trustee with respect to the series. However, this direction must not be in conflict with any rule of law or the applicable indenture, and must not be unjustly prejudicial to the holder(s) of any Subordinated Debt Securities of that series not taking part in the direction, as determined by the trustee. The trustee may also take any other action, consistent with the direction, that it deems proper.

Table of Contents

The trustee will, within 90 days of a default with respect to the Subordinated Debt Securities of any series, give to each affected holder of the Subordinated Debt Securities of the affected series notice of any default it knows about, unless the default has been cured or waived. However, except in the case of a default in the payment of the principal of, or premium, if any, or interest, if any, on any Subordinated Debt Securities, the trustee will be entitled to withhold notice if the board of directors, the executive committee or a trust committee of directors or responsible officers of the trustee determine in good faith that withholding of notice is in the interest of the holder(s).

We are required to furnish to the trustee annually a statement as to our compliance with all conditions and covenants under each Subordinated Debt Indenture.

Limitations on suits. Before a holder may bypass the trustee and bring its own lawsuit or other formal legal action or take other steps to enforce its rights or protect its interests relating to the debt securities, the following must occur:

- The holder must give the trustee written notice that an event of default has occurred and remains uncured.
- The holders of 25% in principal amount of all outstanding debt securities of the relevant series must make a written request that the trustee take action because of the default, and the holder must offer reasonable indemnity to the trustee against the cost and other liabilities of taking that action.
- The trustee must not have taken action for 60 days after receipt of the above notice and offer of indemnity, and the trustee must not have received an inconsistent direction from the majority in principal amount of all outstanding debt securities of the relevant series during that period.
- In the case of our winding-up in England, such legal action or proceeding is in the name and on behalf of the trustee to the same extent, but no further, as the trustee would have been entitled to do.

Notwithstanding any contrary provisions, nothing shall impair the right of a holder, absent the holder's consent, to sue for any payments due but unpaid with respect to the Subordinated Debt Securities.

Street name and other indirect holders should consult their banks or brokers for information on how to give notice or direction to or make a request of the trustee and how to waive any past Subordinated Event of Default, Dated Debt Default or Undated Debt Default.

Consolidation, Merger and Sale of Assets; Assumption

We may, without the consent of the holders of any of the debt securities, consolidate with, merge into or transfer or lease our assets substantially as an entirety to, any person of the persons specified in the applicable indenture. However, any successor corporation formed by any consolidation or amalgamation, or any transferee or lessee of our assets, must be a bank organized under the laws of the United Kingdom that assumes our obligations on the debt securities and the applicable indenture, and a number of other conditions must be met.

Subject to applicable law and regulation, any of our wholly-owned subsidiaries may assume our obligations under the debt securities of any series without the consent of any holder. We, however, must irrevocably guarantee, (on a subordinated basis in substantially the manner described under " – Ranking" above, in the case of Subordinated Debt Securities,) the obligations of the subsidiary under the debt securities of that series. If we do, all of our direct obligations under the debt securities of the series and the applicable indenture shall immediately be discharged. Unless the relevant prospectus supplement provides otherwise, any Additional Amounts under the debt securities of the series will be payable in respect of taxes imposed by the jurisdiction in which the successor entity is organized, rather than taxes imposed by a U.K. taxing jurisdiction, subject to exceptions equivalent to those that apply to any obligation to pay Additional Amounts in respect of taxes imposed by a U.K. taxing jurisdiction. However, if we make payment under this guarantee, we shall also be required to pay Additional Amounts related to taxes (subject to the exceptions set forth in " – Additional Amounts" above) imposed by a U.K. taxing

Table of Contents

jurisdiction due to this guarantee payment. A subsidiary that assumes our obligations will also be entitled to redeem the debt securities of the relevant series in the circumstances described in " – Redemption" above with respect to any change or amendment to, or change in the application or interpretation of the laws or regulations (including any treaty) of the assuming corporation's jurisdiction of incorporation as long as the change or amendment occurs after the date of the subsidiary's assumption of our obligations. However, the determination of whether the applicable solvency condition has been satisfied shall continue to be made with reference to us, unless applicable law requires otherwise.

The U.S. Internal Revenue Service might deem an assumption of our obligations as described above to be an exchange of the existing debt securities for new debt securities, resulting in a recognition of taxable gain or loss and possibly other adverse tax consequences. Investors should consult their tax advisors regarding the tax consequences of such an assumption.

Governing Law

The debt securities and indentures will be governed by and construed in accordance with the laws of New York State, except that, as specified in the relevant Subordinated Debt Indenture, the subordination provisions of each series of Subordinated Debt Securities and the related indenture will be governed by and construed in accordance with the laws of England.

Notices

Notices regarding the debt securities will be valid:

- with respect to global debt securities, if in writing and delivered or mailed to each direct holder;
- if registered debt securities are affected, if given in writing and mailed to each direct holder as provided in the applicable indenture; or
- with respect to bearer definitive debt securities, if published at least once in an Authorized Newspaper (as defined in the indentures) in the Borough of Manhattan in New York City and as the applicable prospectus supplement may specify otherwise.

Any notice shall be deemed to have been given on the date of such publication or, if published more than once, on the date of the first publication. If publication is not practicable, notice will be valid if given in any other manner, and deemed to have been given on the date, as we shall determine.

The Trustee

The Bank of New York will be the trustee under the indentures. The trustee has two principal functions:

- First, it can enforce an investor's rights against us if we default on debt securities issued under the indenture. There are some limitations on the extent to which the trustee acts on an investor's behalf, described under "Senior Events of Default; Subordinated Event of Default and Defaults; Limitation of Remedies"; and
- Second, the trustee performs administrative duties for us, such as sending the investor's interest payments, transferring debt securities to a new buyer and sending investors notices.

We and some of our subsidiaries maintain deposit accounts and conduct other banking transactions with the trustee in the ordinary course of our respective businesses.

Consent to Service

The indentures provide that we irrevocably designate Barclays Bank PLC, 200 Park Avenue, New York, New York 10166, Attention: General Counsel as our authorized agent for service of process in any proceeding arising out of or relating to the indentures or debt securities brought in any federal or state court in New York City and we irrevocably submit to the jurisdiction of these courts.

Clearance and Settlement

Debt securities we issue may be held through one or more international and domestic clearing systems. The principal clearing systems we will use are the book-entry systems operated by The Depository

Table of Contents

Trust Company, or DTC, in the United States, Clearstream Banking, société anonyme, or Clearstream, Luxembourg, in Luxembourg and Euroclear Bank S.A./N.V., or Euroclear, in Brussels, Belgium. These systems have established electronic securities and payment transfer, processing, depositary and custodial links among themselves and others, either directly or through custodians and depositories. These links allow securities to be issued, held and transferred among the clearing systems without the physical transfer of certificates.

Special procedures to facilitate clearance and settlement have been established among these clearing systems to trade securities across borders in the secondary market. Where payments for debt securities we issue in global form will be made in U.S. dollars, these procedures can be used for cross-market transfers and the securities will be cleared and settled on a delivery against payment basis.

Global securities will be registered in the name of a nominee for, and accepted for settlement and clearance by, one or more of Euroclear, Clearstream, Luxembourg, DTC and any other clearing system identified in the applicable prospectus supplement.

Cross-market transfers of debt securities that are not in global form may be cleared and settled in accordance with other procedures that may be established among the clearing systems for these securities.

Euroclear and Clearstream, Luxembourg hold interests on behalf of their participants through customers' securities accounts in the names of Euroclear and Clearstream, Luxembourg on the books of their respective depositories, which, in the case of securities for which a global security in registered form is deposited with the DTC, in turn hold such interests in customers' securities accounts in the depositories' names on the books of the DTC.

The policies of DTC, Clearstream, Luxembourg and Euroclear will govern payments, transfers, exchange and other matters relating to the investors' interest in securities held by them. This is also true for any other clearance system that may be named in a prospectus supplement.

We have no responsibility for any aspect of the actions of DTC, Clearstream, Luxembourg or Euroclear or any of their direct or indirect participants. We have no responsibility for any aspect of the records kept by DTC, Clearstream, Luxembourg or Euroclear or any of their direct or indirect participants. We also do not supervise these systems in any way. This is also true for any other clearing system indicated in a prospectus supplement.

DTC, Clearstream, Luxembourg, Euroclear and their participants perform these clearance and settlement functions under agreements they have made with one another or with their customers. Investors should be aware that they are not obligated to perform these procedures and may modify them or discontinue them at any time.

The description of the clearing systems in this section reflects our understanding of the rules and procedures of DTC, Clearstream, Luxembourg and Euroclear as they are currently in effect. Those systems could change their rules and procedures at any time.

The Clearing Systems

DTC. DTC has advised us as follows:

- DTC is:

  (1) a limited purpose trust company organized under the laws of the State of New York;

  (2) a "banking organization" within the meaning of New York Banking Law;

  (3) a member of the Federal Reserve System;

  (4) a "clearing corporation" within the meaning of the New York Uniform Commercial Code; and

  (5) a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934.

- DTC was created to hold securities for its participants and to facilitate the clearance and settlement of securities transactions between participants through electronic book-entry changes to accounts of its participants. This eliminates the need for physical movement of securities.

Table of Contents

- Participants in DTC include securities brokers and dealers, banks, trust companies and clearing corporations and may include certain other organizations. DTC is partially owned by some of these participants or their representatives.
- Indirect access to the DTC system is also available to banks, brokers and dealers and trust companies that have custodial relationships with participants.
- The rules applicable to DTC and DTC participants are on file with the SEC.

Clearstream, Luxembourg. Clearstream, Luxembourg has advised us as follows:

- Clearstream, Luxembourg is a duly licensed bank organized as a société anonyme incorporated under the laws of Luxembourg and is subject to regulation by the Luxembourg Commission for the Supervision of the Financial Sector (Commission de Surveillance du Secteur Financier).
- Clearstream, Luxembourg holds securities for its customers and facilitates the clearance and settlement of securities transactions among them. It does so through electronic book-entry transfers between the accounts of its customers. This eliminates the need for physical movement of securities.
- Clearstream, Luxembourg provides other services to its customers, including safekeeping, administration, clearance and settlement of internationally traded securities and lending and borrowing of securities.
- Clearstream, Luxembourg's customers include worldwide securities brokers and dealers, banks, trust companies and clearing corporations and may include professional financial intermediaries. Its U.S. customers are limited to securities brokers and dealers and banks.
- Indirect access to the Clearstream, Luxembourg system is also available to others that clear through Clearstream, Luxembourg customers or that have custodial relationships with its customers, such as banks, brokers, dealers and trust companies.

Euroclear. Euroclear has advised us as follows:

- Euroclear is incorporated under the laws of Belgium as a bank and is subject to regulation by the Belgian Banking and Finance Commission (Commission Bancaire et Financière) and the National Bank of Belgium (Banque Nationale de Belgique).
- Euroclear holds securities for its customers and facilitates the clearance and settlement of securities transactions among them. It does so through simultaneous electronic book-entry delivery against payment, thereby eliminating the need for physical movement of certificates.
- Euroclear provides other services to its customers, including credit, custody, lending and borrowing of securities and tri-party collateral management. It interfaces with the domestic markets of several countries.
- Euroclear customers include banks, including central banks, securities brokers and dealers, banks, trust companies and clearing corporations and certain other professional financial intermediaries.
- Indirect access to the Euroclear system is also available to others that clear through Euroclear customers or that have custodial relationships with Euroclear customers.
- All securities in Euroclear are held on a fungible basis. This means that specific certificates are not matched to specific securities clearance accounts.

Other Clearing Systems. We may choose any other clearing system for a particular series of debt securities. The clearance and settlement procedures for the clearing system we choose will be described in the applicable prospectus supplement.

Table of Contents

Primary Distribution

The distribution of the debt securities will be cleared through one or more of the clearing systems that we have described above or any other clearing system that is specified in the applicable prospectus supplement. Payment for securities will be made on a delivery versus payment or free delivery basis. These payment procedures will be more fully described in the applicable prospectus supplement.

Clearance and settlement procedures may vary from one series of debt securities to another according to the currency that is chosen for the specific series of securities. Customary clearance and settlement procedures are described below.

We will submit applications to the relevant system or systems for the securities to be accepted for clearance. The clearance numbers that are applicable to each clearance system will be specified in the prospectus supplement.

Clearance and Settlement Procedures-DTC. DTC participants that hold debt securities through DTC on behalf of investors will follow the settlement practices applicable to United States corporate debt obligations in DTC's Same-Day Funds Settlement System.

Debt securities will be credited to the securities custody accounts of these DTC participants against payment in same-day funds, for payments in U.S. dollars, on the settlement date. For payments in a currency other than U.S. dollars, securities will be credited free of payment on the settlement date.

Clearance and Settlement Procedures-Euroclear and Clearstream, Luxembourg. We understand that investors that hold their debt securities through Euroclear or Clearstream, Luxembourg accounts will follow the settlement procedures that are applicable to conventional Eurobonds in registered form.

Debt securities will be credited to the securities custody accounts of Euroclear and Clearstream, Luxembourg participants on the business day following the settlement date, for value on the settlement date. They will be credited either free of payment or against payment for value on the settlement date.

Secondary Market Trading

Trading Between DTC Participants. Secondary market trading between DTC participants will occur in the ordinary way in accordance with DTC's rules. Secondary market trading will be settled using procedures applicable to United States corporate debt obligations in DTC's Same-Day Funds Settlement System.

If payment is made in U.S. dollars, settlement will be in same-day funds. If payment is made in a currency other than U.S. dollars, settlement will be free of payment. If payment is made other than in U.S. Dollars, separate payment arrangements outside of the DTC system must be made between the DTC participants involved.

Trading Between Euroclear and/or Clearstream, Luxembourg Participants. We understand that secondary market trading between Euroclear and/or Clearstream, Luxembourg participants will occur in the ordinary way following the applicable rules and operating procedures of Euroclear and Clearstream, Luxembourg. Secondary market trading will be settled using procedures applicable to conventional Eurobonds in registered form.

Trading Between a DTC Seller and a Euroclear or Clearstream, Luxembourg Purchaser. A purchaser of debt securities that are held in the account of a DTC participant must send instructions to Euroclear or Clearstream, Luxembourg at least one business day prior to settlement. The instructions will provide for the transfer of the securities from the selling DTC participant's account to the account of the purchasing Euroclear or Clearstream, Luxembourg participant. Euroclear or Clearstream, Luxembourg, as the case may be, will then instruct the common depositary for Euroclear and Clearstream, Luxembourg to receive the securities either against payment or free of payment.

The interests in the securities will be credited to the respective clearing system. The clearing system will then credit the account of the participant, following its usual procedures. Credit for the securities will appear on the next day, European time. Cash debit will be back-valued to, and the interest on the securities will accrue from, the value date, which would be the preceding day, when settlement occurs in New York. If the trade fails and settlement is not

Table of Contents

completed on the intended date, the Euroclear or Clearstream, Luxembourg cash debit will be valued as of the actual settlement date instead.

Euroclear participants or Clearstream, Luxembourg participants will need the funds necessary to process same-day funds settlement. The most direct means of doing this is to preposition funds for settlement, either from cash or from existing lines of credit, as for any settlement occurring within Euroclear or Clearstream, Luxembourg. Under this approach, participants may take on credit exposure to Euroclear or Clearstream, Luxembourg until the securities are credited to their accounts one business day later.

As an alternative, if Euroclear or Clearstream, Luxembourg has extended a line of credit to them, participants can choose not to pre-position funds and will instead allow that credit line to be drawn upon to finance settlement. Under this procedure, Euroclear participants or Clearstream, Luxembourg participants purchasing securities would incur overdraft charges for one business day (assuming they cleared the overdraft as soon as the securities were credited to their accounts). However, interest on the securities would accrue from the value date. Therefore, in many cases, the investment income on securities that is earned during that one business day period may substantially reduce or offset the amount of the overdraft charges. This result will, however, depend on each participant's particular cost of funds.

Because the settlement will take place during New York business hours, DTC participants will use their usual procedures to deliver securities to the depositary on behalf of Euroclear participants or Clearstream, Luxembourg participants. The sale proceeds will be available to the DTC seller on the settlement date. For the DTC participants, then, a cross-market transaction will settle no differently than a trade between two DTC participants.

Special Timing Considerations

Investors should be aware that they will only be able to make and receive deliveries, payments and other communications involving the debt securities through Clearstream, Luxembourg and Euroclear on days when those systems are open for business. Those systems may not be open for business on days when banks, brokers and other institutions are open for business in the United States.

In addition, because of time-zone differences, there may be problems with completing transactions involving Clearstream, Luxembourg and Euroclear on the same business day as in the United States. U.S. investors who wish to transfer their interests in the debt securities, or to receive or make a payment or delivery of the debt securities, on a particular day, may find that the transactions will not be performed until the next business day in Luxembourg or Brussels, depending on whether Clearstream, Luxembourg or Euroclear is used.

DESCRIPTION OF PREFERENCE SHARES

The following is a summary of the general terms of the preference shares of any series we may issue under this registration statement. Each time we issue preference shares we will prepare a prospectus supplement, which you should read carefully. The prospectus supplement relating to a series of preference shares or to a series of debt securities that are convertible into or exchangeable for the preference shares will summarize the terms of the preference shares of the particular series. Those terms will be set out in the resolutions establishing the series that our Board of Directors or an authorized committee adopt, and may be different from those summarized below. If so, the applicable prospectus supplement will state that, and the description of the preference shares of that series contained in the prospectus supplement will apply.

This summary does not purport to be complete and is subject to, and qualified by, our Articles of Association and the resolutions of the Board of Directors or an authorized committee. You should read our Articles of Association as well as those resolutions, which we have filed or we will file with the SEC as an exhibit to the registration statement, of which this prospectus is a part. You should also read the summary of the general terms of the deposit agreement under which ADRs evidencing ADSs that may represent preference shares may be issued, under the heading "Description of American Depositary Receipts".

General

Under our Articles of Association, our Board of Directors or an authorized committee of the Board is empowered to provide for the issuance of U.S. dollar-denominated preference shares, in one or more series.

Table of Contents

The resolutions providing for their issue, adopted by the Board of Directors or the authorized committee, will set forth the dividend rights, liquidation value per share, redemption provisions, voting rights, other rights, preferences, privileges, limitations and restrictions of the preference shares.

As of the date of this prospectus, we have 100,000 outstanding dollar-denominated preference shares, Series 1.

The preference shares of any series will be U.S. dollar-denominated in terms of nominal value, dividend rights and liquidation value per share. They will, when issued, be fully paid and non- assessable. For each preference share issued, an amount equal to its nominal value will be credited to our issued share capital account and an amount equal to the difference between its issue price and its nominal value will be credited to our share premium account. Unless the applicable prospectus supplement specifies otherwise, the preference shares will have a nominal value of $.25 or $100 per share. The preference shares of a series deposited under the deposit agreement referred to in the section “Description of American Depositary Receipts’ will be represented by ADSs of a corresponding series, evidenced by ADRs of the series. The preference shares of these series may only be withdrawn from deposit in registered form. See “Description of American Depositary Receipts”.

The Board of Directors or the authorized committee may only provide for the issuance of preference shares of any series if a resolution of our shareholders has authorized the allotment.

The preference shares of any series will have the dividend rights, rights upon liquidation, redemption provisions and voting rights described below, unless the relevant prospectus supplement provides otherwise. You should read the prospectus supplement for the specific terms of any series, including:

- the number of shares offered, the number of shares offered in the form of ADSs and the number of preference shares represented by each ADS;
- the public offering price of the series;
- the liquidation value per share of that series;
- the dividend rate, or the method of calculating it;
- the place where we will pay dividends;
- the dates on which dividends will be payable;
- voting rights of that series of preference shares, if any;
- restrictions applicable to the sale and delivery of the preference shares;
- whether and under what circumstances we will pay additional amounts on the preference shares in the event of certain developments with respect to withholding tax or information reporting laws;
- any redemption, conversion or exchange provisions;
- whether the shares shall be issued as units with shares of a related series;
- any listing on a securities exchange; and
- any other rights, preferences, privileges, limitations and restrictions relating to the series.

The prospectus supplement will also describe material U.S. and U.K. tax considerations that apply to any particular series of preference shares.

Title to preference shares of a series in registered form will pass by transfer and registration on the register that the registrar shall keep at its office in the United Kingdom. For more information on the registration, you should read “Registrar and Paying Agent”. The registrar will not charge for the registration of transfer, but the person requesting it will be liable for any taxes, stamp duties or other governmental charges.

We may issue preference shares in more than one related series if necessary to ensure that we continue to be treated as part of the Barclays PLC Group for

Table of Contents

U.K. tax purposes. The preference shares of any two or more related series will be issued as preference share units, unless the applicable prospectus supplement specifies otherwise, so that holders of any preference share units will effectively have the same rights, preferences and privileges, and will be subject to the same limitations and restrictions. The following characteristics, however, may differ:

- the aggregate amount of dividends,
- the aggregate amounts which may be payable upon redemption,
- the redemption dates,
- the rights of holders to deposit the preference shares under the deposit agreement, and
- the voting rights of holders.

You should read the applicable prospectus supplement for the characteristics relating to any preference shares issuable in two or more related series as a unit.

Unless the applicable prospectus supplement specifies otherwise, the preference shares of each series will rank equally as to participation in our profits and assets with the preference shares of each other series.

Our affiliates may resell preferred shares after their initial issuance in market-making transactions. We describe these transactions above under “Description of Debt Securities – General – Market-Making Transactions.”

Dividend Rights

The holders of the preference shares will be entitled to receive cash dividends on the dates and at the rates as described in the applicable prospectus supplement out of our “distributable profits” when, as and if the dividends are declared by our Board of Directors or an authorized committee. Except as provided in this prospectus and in the applicable prospectus supplement, holders of preference shares will have no right to participate in our profits.

For information concerning the declaration of dividends out of our distributable profits, see “Description of Share Capital – Ordinary Shares – Dividend Rights”.

We will pay the dividends declared on the preference shares of a series to the record holders as they appear on the register on the record dates. A record date will be not less than 30 nor more than 60 days before the relevant dividend payment date, as will be fixed by our Board of Directors or an authorized committee. Subject to applicable fiscal or other laws and regulations, each payment will be made by dollar check drawn on a bank in London or in New York City and mailed to the record holder at the holder’s address as it appears on the register for the preference shares. If any date on which dividends are payable on the preference shares is not a “business day”, which is a day on which banks are open for business and on which foreign exchange dealings may be conducted in London and in New York City, then payment of the dividend payable on that date will be made on the next business day. There will be no additional interest or other payment due to this type of delay.

Dividends on the preference shares of any series will be non-cumulative. If our Board of Directors or an authorized committee fails to declare a dividend payable on a dividend payment date in respect of the preference shares of a series, then the right of holders of preference shares of the series to receive a dividend in respect of the dividend period ending on that dividend payment date will be lost. We will have no obligation to pay the dividend accrued for that dividend period or to pay any interest on the dividend, whether or not dividends on the preference shares of that series or any other series or class of our shares are declared for any subsequent dividend period.

No full dividends will be declared or paid or set apart for payment on any of our preference shares ranking, as to dividends, equally with or below the preference shares of any series for any period unless full dividends have been, or at the same time are, declared and paid, or declared and set aside for payment, on the preference shares of that series for the then-current dividend period. When dividends are not paid in full upon the preference shares of a series and any other of our preference shares ranking equally as to dividends, all dividends declared upon the preference shares of that series and the other

Table of Contents

preference shares will be declared pro rata so that dividends declared upon the preference shares of each series are in proportion to dividends accrued on the preference shares of the series.

Except as provided in the preceding sentence, unless full dividends on all outstanding preference shares of a series have been paid for the most recently completed dividend period, no dividends, other than in our ordinary shares or other shares ranking below the preference shares of the series as to dividends and upon liquidation, will be declared or paid or set apart for payment, or other distribution made, upon our ordinary shares or other shares ranking, as to dividends or upon liquidation, equally with or below the preference shares of the series. In addition, we will not redeem, repurchase or otherwise acquire for consideration, or pay any money or make any money available for a sinking fund for the redemption of, any of our ordinary shares or other shares ranking equally with or below the preference shares of the series as to dividends or upon liquidation, except by conversion into or exchange for shares ranking below the preference shares of the series as to dividends and upon liquidation, until we have resumed the payment of full dividends for four consecutive quarterly dividend periods on all outstanding preference shares of the series and those ranking equally as to dividends with the preference shares of the series.

We will compute the amount of dividends payable on the preference shares of any series for each dividend period based upon the liquidation value per share of the preference shares of the series by annualizing the applicable dividend rate and dividing by the number of dividend periods in a year. However, we will compute the amount of dividends payable for any dividend period shorter than a full dividend period on the basis of a 360-day year divided into twelve months of 30 days each and, in the case of an incomplete month, on the basis of the actual number of days elapsed.

Rights Upon Liquidation

If there is a return of capital in respect of our voluntary or involuntary liquidation, dissolution, winding-up or otherwise, other than in respect of any redemption or repurchase of the preference shares of a series in whole or in part permitted by our Articles of Association and under applicable law, the holders of the outstanding preference shares of a series will be entitled to receive liquidating distributions. Liquidating distributions will:

- come from the assets we have available for distribution to shareholders, before any distribution of assets is made to holders of our ordinary shares or any other class of shares ranking below the preference shares upon a return of capital; and
- be in an amount equal to the liquidation value per share of the preference shares, plus an amount equal to accrued and unpaid dividends, whether or not declared or earned, for the then-current dividend period up to and including the date of commencement of our winding-up or the date of any other return of capital, as the case may be.

If, upon a return of capital, the assets available for distribution are insufficient to pay in full the amounts payable on the preference shares and any other of our shares ranking as to any distribution equally with the preference shares, the holders of the preference shares and of the other shares will share pro rata in any distribution of our assets in proportion to the full respective liquidating distributions to which they are entitled. After payment of the full amount of the liquidating distribution to which they are entitled, the holders of the preference shares of that series will have no claim on any of our remaining assets and will not be entitled to any further participation in the return of capital. If there is a sale of all or substantially all of our assets, the distribution to our shareholders of all or substantially all of the consideration for the sale, unless the consideration, apart from assumption of liabilities, or the net proceeds consists entirely of cash, will not be deemed a return of capital in respect of our liquidation, dissolution or winding-up.

Redemption

Unless the relevant prospectus supplement specifies otherwise, we may redeem the preference shares of each series, at our option, in whole or in part, at any time and from time to time on the dates and at the redemption prices and on all other terms and conditions as set forth in the applicable prospectus supplement. Preference shares comprising preference share units will be redeemed only as units.

Table of Contents

If fewer than all of the outstanding preference shares of a series are to be redeemed, we will select by lot, in the presence of our independent auditors, which particular preference shares will be redeemed.

If we redeem preference shares of a series, we will mail a redemption notice to each record holder of preference shares to be redeemed between 30 and 60 days before the redemption date. Each redemption notice will specify:

- the redemption date;
- the particular preference shares of the series to be redeemed;
- the redemption price, specifying the included amount of accrued and unpaid dividends;
- that any dividends will cease to accrue upon the redemption of the preference shares; and
- the place or places where holders may surrender documents of title and obtain payment of the redemption price.

No defect in the redemption notice or in the giving of notice will affect the validity of the redemption proceedings.

If we give notice of redemption in respect of the preference shares of a series, then, by 12:00 noon, London time, on the redemption date, we will irrevocably deposit with the paying agent funds sufficient to pay the applicable redemption price, including the amount of accrued and unpaid dividends for the then-current quarterly dividend period to the date fixed for redemption. We will also give the paying agent irrevocable instructions and authority to pay the redemption price to the holders of those preference shares called for redemption.

If we give notice of redemption, then, when we make the deposit with the paying agent, all rights of holders of the preference shares of the series called for redemption will cease, except the holders' right to receive the redemption price, but without interest, and these preference shares will no longer be outstanding. Subject to any applicable fiscal or other laws and regulations, payments in respect of the redemption of preference shares of a series will be made by dollar check drawn on a bank in London or in New York City against presentation and surrender of the relevant share certificates at the office of the paying agent located in the United Kingdom.

In the event that any date on which a redemption payment on the preference shares is to be made is not a business day, then payment of the redemption price payable on that date will be made on the next business day. There will be no interest or other payment due to the delay. If payment of the redemption price is improperly withheld or refused, dividends on the preference shares will continue to accrue at the then applicable rate, from the redemption date to the date of payment of the redemption price.

Subject to applicable law, including U.S. securities laws, we may purchase outstanding preference shares of any series by tender, in the open market or by private agreement. Unless we tell you otherwise in the applicable prospectus supplement, any preference shares of any series that we purchase for our own account, other than in the ordinary course of a business of dealing in securities, will be treated as canceled and will no longer be issued and outstanding.

Under the current practices of the Financial Services Authority, we may not redeem or purchase any preference shares unless the Financial Services Authority consents in advance.

Voting Rights

The holders of the preference shares of any series will not be entitled to receive notice of, attend or vote at any general meeting of our shareholders except as provided below or in the applicable prospectus supplement.

Failure to pay dividends

If we fail to pay the equivalent of six consecutive quarterly dividends payable on the preference shares of a series or any other of our preference shares ranking, as to dividends, equally with the preference shares of that series, then the holders of the outstanding preference shares of all of those series, excluding any series of outstanding preference shares which do not have voting rights, will be entitled to appoint two additional members to our Board of

Table of Contents

Directors, and to remove either member from office and to appoint another person in place of the member. In exercising this entitlement, the holders will act as a single class without regard to series, either:

- by written notice given by the holders of a majority in nominal value of the preference shares, or
- by ordinary resolution passed by a majority of the holders of the preference shares present in person or by proxy at a separate general meeting of the holders convened for the purpose.

No more than 30 days after this entitlement arises, the Board of Directors or an authorized committee will convene a separate general meeting for the above purpose. If the Board of Directors or authorized committee does not convene this meeting within 30 days, the holders of 10% of the aggregate nominal value of the outstanding preference shares of the series and any other preference shares, excluding any series of preference shares which do not have voting rights, will be entitled to convene the meeting. The provisions of our Articles of Association relating to the convening and conduct of general meetings of shareholders will apply to this separate general meeting, except where the provisions are inconsistent with the terms of this paragraph.

Any member of the Board of Directors appointed in this manner shall vacate office if, following the event which gave rise to the appointment, we have resumed the payment of dividends on all of the relevant preference shares for the equivalent of four consecutive quarterly dividend periods. Our Articles of Association provide for a minimum of five members of the Board of Directors, disregarding alternate Directors, with no limit on the maximum number of members. The Financial Services Authority requires that it be satisfied on an ongoing basis that each member of our Board of Directors is fit and proper to hold his or her position. As of the date of this prospectus, our Board of Directors has 12 members.

Variation of Rights

If applicable law permits, the rights, preferences and privileges attached to any series of preference shares may be varied or abrogated only with the written consent of the holders of at least three-fourths of the outstanding preference shares of the series or with the sanction of a special resolution passed at a separate general meeting of the holders of the outstanding preference shares of the series. A special resolution will be adopted if passed by a majority of at least three-fourths of those holders voting in person or by proxy at the meeting. The quorum required for this separate general meeting will be persons holding or representing by proxy at least one-third of the outstanding preference shares of the affected series, except that if at any adjourned meeting where this quorum requirement is not met, any two holders present in person or by proxy will constitute a quorum.

In addition to the voting rights referred to above, if any resolution is proposed for our liquidation, dissolution or winding-up, then the holders of the outstanding preference shares of each series, other than any series of preference shares which do not have voting rights, will be entitled to receive notice of and to attend the general meeting of shareholders called for the purpose of adopting the resolution and will be entitled to vote on that resolution, but no other. When entitled to vote, each holder of preference shares of a series present in person or by proxy has one vote for each preference share held.

Notices of Meetings

A notice of any meeting at which holders of preference shares of a particular series are entitled to vote will be mailed to each record holder of preference shares of that series. Each notice will state:

- the date of the meeting;
- a description of any resolution to be proposed for adoption at the meeting on which those holders are entitled to vote; and
- instructions for the delivery of proxies.

A holder of preference shares of any series in registered form who is not registered with an address in the United Kingdom and who has not supplied an address within the United Kingdom to us for the purpose of notices is not entitled to receive notices of meetings from us. For a description of notices that we

Table of Contents

will give to the ADR depositary and that the ADR depositary will give to ADR holders, you should read "Description of American Depositary Receipts – Reports and Notices" and "Where You Can Find More Information".

Registrar and Paying Agent

Our registrar, presently located at One Canada Square, London E14 5AL, England, England will act as registrar and paying agent for the preference shares of each series.

DESCRIPTION OF AMERICAN DEPOSITARY RECEIPTS

The following is a summary of the general terms and provisions of the deposit agreement under which the ADR depositary will issue the ADRs. The deposit agreement is among us, The Bank of New York, as ADR depositary, and all holders from time to time of ADRs issued under the deposit agreement. This summary does not purport to be complete. We may amend or supersede all or part of this summary to the extent we tell you in the applicable prospectus supplement. You should read the deposit agreement, which is filed with the SEC as an exhibit to the registration statement, of which this prospectus is a part. You may also read the deposit agreement at the corporate trust office of The Bank of New York in New York City and the office of The Bank of New York in London.

Depositary

The Bank of New York will act as the ADR depositary. The office of The Bank of New York in London will act as custodian. The ADR depositary's principal office in New York City is presently located at 101 Barclay Street, Floor 21 West, New York, New York 10286, and the custodian's office is presently located at One Canada Square, London E14 5AL, England.

American Depositary Receipts

An ADR is a certificate evidencing a specific number of ADSs of a specific series, each of which will represent preference shares of a corresponding series. Unless the relevant prospectus supplement specifies otherwise, each ADS will represent one preference share, or evidence of rights to receive one preference share, deposited with the London branch of The Bank of New York, as custodian. An ADR may evidence any number of ADSs in the corresponding series.

Deposit and Issuance of ADRs

When the custodian has received preference shares of a particular series, or evidence of rights to receive preference shares, and applicable fees, charges and taxes, subject to the deposit agreement's terms, the ADR depositary will execute and deliver at its corporate trust office in New York City to the person(s) specified by us in writing, an ADR or ADRs registered in the name of such person(s) evidencing the number of ADSs of that series corresponding to the preference shares of that series.

When the ADR depositary has received preference shares of a particular series, or evidence of rights to receive preference shares, and applicable fees, charges and taxes, subject to the deposit agreement's terms, the ADR depositary will execute and deliver at its principal office to the person(s) specified by us in writing, an ADR or ADRs registered in the name of that person(s) evidencing the number of ADSs of that series corresponding to the preference shares of that series. Preference shares may be deposited under the deposit agreement as units comprising a preference share of a series and a preference share of a related series. The ADR depositary's principal office is presently located at 101 Barclay Street, Floor 21 West, New York, New York 10286.

Withdrawal of Deposited Securities

Upon surrender of ADRs at the ADR depositary's corporate trust office in New York City and upon payment of the taxes, charges and fees provided in the deposit agreement and subject to its terms, an ADR holder is entitled to delivery, to or upon its order, at the ADR depositary's corporate trust office in New York City or the custodian's office in London, of the amount of preference shares of the relevant series represented by the ADSs evidenced by the surrendered ADRs. The ADR holder will bear the risk and expense for the forwarding of share certificates and other documents of title to the corporate trust office of the ADR depositary.

Holders of preference shares that have been withdrawn from deposit under the deposit agreement will not have the right to redeposit the preference shares.

Table of Contents

Dividends and Other Distributions

The ADR depositary will distribute all cash dividends or other cash distributions that it receives in respect of deposited preference shares of a particular series to ADR holders, after payment of any charges and fees provided for in the deposit agreement, in proportion to their holdings of ADSs of the series representing the preference shares. The cash amount distributed will be reduced by any amounts that we or the ADR depositary must withhold on account of taxes.

If we make a non-cash distribution in respect of any deposited preference shares of a particular series, the ADR depositary will distribute the property it receives to ADR holders, after deduction or upon payment of any taxes, charges and fees provided for in the deposit agreement, in proportion to their holdings of ADSs of the series representing the preference shares. If a distribution that we make in respect of deposited preference shares of a particular series consists of a dividend in, or free distribution of, preference shares of that series, the ADR depositary may, if we approve, and will, if we request, distribute to ADR holders, in proportion to their holdings of ADSs of the relevant series, additional ADRs evidencing an aggregate number of ADSs of that series representing the amount of preference shares received as such dividend or free distribution. If the ADR depositary does not distribute additional ADRs, each ADS of that series will from then forward also represent the additional preference shares of the corresponding series distributed in respect of the deposited preference shares before the dividend or free distribution.

If the ADR depositary determines that any distribution of property, other than cash or preference shares of a particular series, cannot be made proportionately among ADR holders or if for any other reason, including any requirement that we or the ADR depositary withhold an amount on account of taxes or other governmental charges, the ADR depositary deems that such a distribution is not feasible, the ADR depositary may dispose of all or part of the property in any manner, including by public or private sale, that it deems equitable and practicable. The ADR depositary will then distribute the net proceeds of any such sale (net of any fees and expenses of the ADR depositary provided for in the deposit agreement) to ADR holders as in the case of a distribution received in cash.

Redemption of ADSs

If we redeem any preference shares of a particular series, the ADR depositary will redeem, from the amounts that it receives from the redemption of deposited preference shares of that series, a number of ADSs of the series representing those preference shares which corresponds to the number of deposited preference shares of that series. The ADS redemption price will correspond to the redemption price per share payable with respect to the redeemed preference shares. If we do not redeem all of the outstanding preference shares of a particular series, the ADR depositary will select the ADSs of the corresponding series to be redeemed, either by lot or pro rata to the number of preference shares represented.

We must give notice of redemption in respect of the preference shares of a particular series to the ADR depositary not less than 30 days before the redemption date. The ADR depositary will promptly deliver the notice to all holders of ADRs of the corresponding series.

Record Date

Whenever any dividend or other distribution becomes payable or shall be made in respect of preference shares of a particular series, or any preference shares of a particular series are to be redeemed, or the ADR depositary receives notice of any meeting at which holders of preference shares of a particular series are entitled to vote, the ADR depositary will fix a record date for the determination of the ADR holders who are entitled to receive the dividend, distribution, amount in respect of redemption of ADSs of the corresponding series, or the net proceeds of their sale, or to give instructions for the exercise of voting rights at the meeting, subject to the provisions of the deposit agreement. This record date will be as near as practicable to the corresponding record date we set.

Voting of the Underlying Deposited Securities

When the ADR depositary receives notice of any meeting or solicitation of consents or proxies of holders of preference shares of a particular series, it will, at our written request and as soon as practicable thereafter, mail to the record holders of ADRs a notice including:

- the information contained in the notice of meeting;

Table of Contents

- a statement that the record holders of ADRs at the close of business on a specified record date will be entitled, subject to any applicable provision of English law, to instruct the ADR depositary as to the exercise of any voting rights pertaining to the preference shares of the series represented by their ADSs; and
- a brief explanation of how they may give instructions, including an express indication that they may instruct the ADR depositary to give a discretionary proxy to designated member or members of our board of directors if no such instruction is received.

The ADR depositary has agreed that it will endeavor, in so far as practical, to vote or cause to be voted the preference shares in accordance with any written non-discretionary instructions of record holders of ADRs that it receives on or before the record date set by the ADR depositary. The ADR depositary will not vote the preference shares except in accordance with such instructions or deemed instructions.

If the ADR depositary does not receive instructions from any ADR holder on or before the date the ADR depositary establishes for this purpose, the ADR depositary will deem such holder to have directed the ADR depositary to give a discretionary proxy to a designated member or members of our board of directors. However, the ADR depositary will not give a discretionary proxy to a designated member or members of our board of directors with respect to any matter as to which we inform the ADR depositary that:

- we do not wish the proxy to be given;
- substantial opposition exists; or
- the rights of holders of the preference shares may be materially affected.

Holders of ADRs evidencing ADSs will not be entitled to vote shares of the corresponding series of preference shares directly.

Inspection of Transfer Books

The ADR depositary will, at its corporate trust office in New York City, keep books for the registration and transfer of ADRs. These books will be open for inspection by ADR holders at all reasonable times. However, this inspection may not be for the purpose of communicating with ADR holders in the interest of a business or object other than our business or a matter related to the deposit agreement or the ADRs.

Reports and Notices

We will furnish the ADR depositary with our annual reports as described under “Where You Can Find More Information” in this prospectus. The ADR depositary will make available at its corporate trust office in New York City, for any ADR holder to inspect, any reports and communications received from us that are both received by the ADR depositary as holder of preference shares and made generally available by us to the holders of those preference shares. This includes our annual report and accounts. Upon written request, the ADR depositary will mail copies of those reports to ADR holders as provided in the deposit agreement.

On or before the first date on which we give notice, by publication or otherwise, of:

- any meeting of holders of preference shares of a particular series;
- any adjourned meeting of holders of preference shares of a particular series; or
- the taking of any action in respect of any cash or other distributions or the offering of any rights in respect of, preference shares of a particular series

we have agreed to transmit to the ADR depositary and the custodian a copy of the notice in the form given or to be given to holders of the preference shares. If requested in writing by us, the ADR depositary will, at our expense, arrange for the prompt transmittal or mailing of such notices, and any other reports or communications made generally available to holders of the preference shares, to all holders of ADRs evidencing ADSs of the corresponding series.

Amendment and Termination of the Deposit Agreement

The form of the ADRs evidencing ADSs of a particular series and any provisions of the deposit agreement relating to those ADRs may at any time

Table of Contents

and from time to time be amended by agreement between us and the ADR depositary, without the consent of holders of ADRs, in any respect which we may deem necessary or advisable. Any amendment that imposes or increases any fees or charges, other than taxes and other governmental charges, registration fees, transmission costs, delivery costs or other such expenses, or that otherwise prejudices any substantial existing right of holders of outstanding ADRs evidencing ADSs of a particular series, will not take effect as to any ADRs until 30 days after notice of the amendment has been given to the record holders of those ADRs. Every holder of any ADR at the time an amendment becomes effective, if it has been given notice, will be deemed by continuing to hold the ADR to consent and agree to the amendment and to be bound by the deposit agreement or the ADR as amended. No amendment may impair the right of any holder of ADRs to surrender ADRs and receive in return the preference shares of the corresponding series represented by the ADSs.

Whenever we direct, the ADR depositary has agreed to terminate the deposit agreement as to ADRs evidencing ADSs of a particular series by mailing a termination notice to the record holders of all ADRs then outstanding at least 30 days before the date fixed in the notice of termination. The ADR depositary may likewise terminate the deposit agreement as to ADRs evidencing ADSs of a particular series by mailing a termination notice to us and the record holders of all ADRs then outstanding if at any time 90 days shall have expired since the ADR depositary delivered a written notice to us of its election to resign and a successor ADR depositary shall not have been appointed and accepted its appointment.

If any ADRs evidencing ADSs of a particular series remain outstanding after the date of any termination, the ADR depositary will then:

- discontinue the registration of transfers of those ADRs,
- suspend the distribution of dividends to holders of those ADRs, and
- not give any further notices or perform any further acts under the deposit agreement, except those listed below, with respect to those ADRs.

The ADR depositary will, however, continue to collect dividends and other distributions pertaining to the preference shares of the corresponding series. It will also continue to sell rights and other property as provided in the deposit agreement and deliver preference shares of the corresponding series, together with any dividends or other distributions received with respect to them and the net proceeds of the sale of any rights or other property, in exchange for ADRs surrendered to it.

At any time after the expiration of one year from the date of termination of the deposit agreement as to ADRs evidencing ADSs of a particular series b, the ADR depositary may sell the preference shares of the corresponding series then held. The ADR depositary will then hold uninvested the net proceeds of any such sales, together with any other cash then held by it under the deposit agreement in respect of those ADRs, unsegregated and without liability for interest, for the pro rata benefit of the holders of ADRs that have not previously been surrendered.

Charges of ADR Depositary

Unless the applicable prospectus supplement specifies otherwise, the ADR depositary will charge the party to whom it delivers ADRs against deposits, and the party surrendering ADRs for delivery of preference shares of a particular series or other deposited securities, property and cash, $5.00 for each 100, or fraction of 100, ADSs evidenced by the ADRs issued or surrendered. We will pay all other charges of the ADR depositary and those of any registrar, co-transfer agent and co-registrar under the deposit agreement, but unless the applicable prospectus supplement specifies otherwise, we will not pay:

- taxes, including issue or transfer taxes, U.K. stamp duty or U.K. stamp duty reserve tax other than that payable on the issue of preference shares to the custodian, and other governmental charges,
- any applicable share transfer or registration fees on deposits or withdrawals of preference shares,
- cable, telex, facsimile transmission and delivery charges which the deposit agreement provides are at the expense of the

Table of Contents

holders of ADRs or persons depositing or withdrawing preference shares of any series, or

- expenses incurred or paid by the ADR depositary in conversion of foreign currency into U.S. dollars.

You will be responsible for any taxes or other governmental charges payable on your ADRs or on the preference shares underlying your ADRs. The ADR depositary may refuse to transfer your ADRs or allow you to withdraw the preference shares underlying your ADRs until such taxes or other charges are paid. It may apply payments owed to you or sell deposited preference shares underlying your ADRs to pay any taxes owed and you will remain liable for any deficiency. If the ADR depositary sells deposited preference shares, it will, if appropriate, reduce the number of ADSs to reflect the sale and pay to you any proceeds, or send to you any property, remaining after it has paid the taxes.

General

Neither the ADR depositary nor we will be liable to ADR holders if prevented or forbidden or delayed by any present or future law of any country or by any governmental authority, any present or future provision of our articles of association or of the preference shares, or any act of God or war or other circumstances beyond our control in performing our obligations under the deposit agreement. The obligations of us both under the deposit agreement are expressly limited to performing our duties without gross negligence or bad faith.

If any ADSs of a particular series are listed on one or more stock exchanges in the U.S., the ADR depositary will act as registrar or, at our request or with our approval, appoint a registrar or one or more co-registrars for registration of the ADRs evidencing the ADSs in accordance with any exchange requirements. The ADR depositary may remove the registrars or co-registrars and appoint a substitute(s) if we request it or with our approval.

The ADRs evidencing ADSs of any series are transferable on the books of the ADR depositary or its agent. However, the ADR depositary may close the transfer books as to ADRs evidencing ADSs of a particular series at any time when it deems it expedient to do so in connection with the performance of its duties or at our request. As a condition precedent to the execution and delivery, registration of transfer, split-up, combination or surrender of any ADR or withdrawal of any preference shares of the corresponding series, the ADR depositary or the custodian may require the person presenting the ADR or depositing the preference shares to pay a sum sufficient to reimburse it for any related tax or other governmental charge and any share transfer or registration fee and any applicable fees payable as provided in the deposit agreement. The ADR depositary may withhold any dividends or other distributions, or may sell for the account of the holder any part or all of the preference shares evidenced by the ADR, and may apply those dividends or other distributions or the proceeds of any sale in payment of the tax or other governmental charge. The ADR holder will remain liable for any deficiency.

Any ADR holder may be required from time to time to furnish the ADR depositary or the custodian with proof satisfactory to the ADR depositary of citizenship or residence, exchange control approval, information relating to the registration on our books or those that the registrar maintains for us for the preference shares in registered form of that series, or other information, to execute certificates and to make representations and warranties that the ADR depositary deems necessary or proper. Until those requirements have been satisfied, the ADR depositary may withhold the delivery or registration of transfer of any ADR or the distribution or sale of any dividend or other distribution or proceeds of any sale or distribution or the delivery of any deposited preference shares or other property related to the ADR. The delivery, transfer and surrender of ADRs of any series may be suspended during any period when the transfer books of the ADR depositary are closed or if we or the ADR depositary deem it necessary or advisable.

The deposit agreement and the ADRs are governed by and construed in accordance with the laws of the State of New York.

Table of Contents

DESCRIPTION OF SHARE CAPITAL

The following is a summary of general information about our share capital and some provisions of our Articles of Association. This summary does not purport to be complete. It is subject to, and qualified by reference to, our Articles of Association, which you should read. We have filed a copy of our Articles of Association with the SEC as an exhibit to the Registration Statement, of which this prospectus is a part.

General

Our authorized share capital consists of 3,000,000,000 ordinary shares of £1 each, 80,000,000 dollar-denominated preference shares of $0.25 each, 400,000 dollar-denominated preference shares of $100 each, 400,000 euro-denominated preference shares of €100 each, 1,000 sterling-denominated preference shares of £1 each and 400,000 sterling-denominated preference shares of £100 each. As of the date of this prospectus, 2,311,360,515 ordinary shares are outstanding (all of which are beneficially held by Barclays PLC), no dollar-denominated preference shares of $0.25 each, 100,000 dollar-denominated preference shares of $100 each, 240,000 euro-denominated preference shares of €100 each, 1,000 sterling-denominated preference shares of £1 each all of which are beneficially held by Barclays PLC and 75,000 sterling-denominated preference shares of £100 each are outstanding.

Ordinary Shares

Dividend Rights

Holders of ordinary shares are entitled to receive on a *pro rata* basis, according to the number of paid-up shares held, any dividends that we may declare at a general meeting of shareholders, but no dividends are payable in excess of the amount that our Board of Directors recommends. The Board of Directors may declare and pay to the holders of ordinary shares interim dividends if, in the opinion of our Board, our distributable reserves justify such payment.

Dividends on ordinary shares, as well as on dollar-denominated preference shares of any series, may only be declared and paid out of our “distributable profits”. Rules prescribed by the Companies Act 1985 of Great Britain determine how much of our funds represent distributable profits. In broad outline, dividend distributions may only be made out of the outstanding balance of accumulated realized profits, less the outstanding balance of any accumulated realized losses, and provided that our net assets are not, or would not be reduced to, less than the total of our paid-up share capital and undistributable reserves.

So long as dollar-denominated preference shares of any series are outstanding and full dividends on them have not been paid (or a sum has not been set aside in full) for any dividend period, no dividends may be declared or paid, or other distribution made, upon our ordinary shares. We may, however, pay dividends on our ordinary shares or other shares ranking below the dollar-denominated preference shares of those series as to dividends upon liquidation. In addition, we may not redeem, repurchase or otherwise acquire for any consideration, or pay or make any moneys available for a sinking fund for the redemption of these shares, except by conversion into or exchange for our shares ranking below the dollar-denominated preference shares as to dividends and upon liquidation, until we have resumed the payment of full dividends (or a sum set aside in full) on all outstanding dollar-denominated preference shares or redeem the relevant preference shares in full.

Rights upon Liquidation

If there is a return of capital on our winding up or otherwise, after payment of all liabilities, and after paying or setting apart for payment the full preferential amounts to which the holders of all outstanding dollar-denominated preference shares of any series and any other of our shares ranking senior to the ordinary shares upon liquidation are entitled, our remaining assets will be divided among the holders of ordinary shares *pro rata* according to the number of ordinary shares held by them.

Voting Rights

Each holder of ordinary shares who is entitled to be present and is present in person or by proxy at a general meeting of shareholders has on a show of hands one vote, and on a poll one vote for each ordinary share held. Voting at any general meeting of shareholders is by show of hands unless a poll is demanded. A poll may be demanded by the chairman of the meeting or by any shareholder present in person or by proxy and entitled to vote.

Table of Contents

Miscellaneous

Holders of ordinary shares and dollar-denominated preference shares have no pre-emptive rights under our Articles of Association. However, except in some cases, English law restricts the ability of our Board of Directors, without appropriate authorization from the holders of our ordinary shares at a general meeting, to:

- allot any shares or rights to subscribe for, or to convert any security into, any of our shares under any circumstances or
- issue for cash ordinary shares or rights to subscribe for, or to convert any security into, ordinary shares other than through rights to existing holders of ordinary shares.

TAX CONSIDERATIONS

United States Taxation

This section describes the material United States federal income tax consequences of owning preference shares, ADSs or debt securities. It is the opinion of Sullivan & Cromwell LLP, our United States tax counsel. It applies to you only if you acquire your preference shares, ADSs or debt securities in an offering and you hold your preference shares, ADSs or debt securities as capital assets for tax purposes. This section does not apply to you if you are a member of a special class of holders subject to special rules, including:

- a dealer in securities,
- a trader in securities that elects to use a mark-to-market method of accounting for your securities holdings,
- a tax-exempt organization,
- a life insurance company,
- a person that holds preference shares, ADSs or debt securities as part of a straddle or a hedging or conversion transaction,
- a person whose functional currency is not the U.S. dollar.
- in the case of debt securities, a bank,
- in the case of preference shares or ADSs, a person liable for alternative minimum tax, or,
- in the case of preference shares or ADSs, a person that actually or constructively owns 10% or more of our voting stock.

This section is based on the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations, published rulings and court decisions, as well as on the income tax convention between the United States of America and the United Kingdom (the “Treaty”). These laws are subject to change, possibly on a retroactive basis. In addition, this section is based in part upon the representations of the ADR depositary. Assuming that each obligation in the deposit agreement and any related agreement will be performed in accordance with its terms, for United States federal income tax purposes, if you hold ADRs evidencing ADSs, you will in general be treated as the owner of the preference shares represented by those ADSs. Exchanges of preference shares for ADSs or ADSs for preference shares generally will not be subject to United States federal income tax.

If a partnership holds the preference shares, ADSs or debt securities, the United States federal income tax treatment of a partner will generally depend on the status of the partner and the tax treatment of the partnership. A partner in a partnership holding the notes should consult its tax advisor with regard to the United States federal income tax treatment of an investment in the notes.

You should consult your own tax advisor regarding the United States federal, state and local and other tax consequences of owning and disposing of preference shares, ADSs or debt securities in your particular circumstances.

U.S. Holders

This subsection describes the material United States federal income tax consequences to a U.S. holder of owning preference shares, ADSs or debt securities. You are a U.S. holder if you are a beneficial owner of preference shares, ADSs or debt securities and you are:

- a citizen or resident of the United States,
- a domestic corporation,

Table of Contents

- an estate whose income is subject to United States federal income tax regardless of its source, or
- a trust if a United States court can exercise primary supervision over the trust's administration and one or more United States persons are authorized to control all substantial decisions of the trust.

Taxation of Debt Securities

This subsection deals only with debt securities that are due to mature 30 years or less from the date on which they are issued. The United States federal income tax consequences of owning debt securities that are due to mature more than 30 years from their date of issue will be discussed in an applicable prospectus supplement. Undated Subordinated Debt Securities generally will not be treated as debt securities for United States federal income tax purposes; the United States federal income tax consequences of owning and disposing Undated Subordinated Debt Securities will be discussed in an applicable prospectus supplement.

Payments of Interest

Except as described below in the case of interest on a discount debt security that is not qualified stated interest, each as defined below under " – Original Issue Discount – General", you will be taxed on any interest on your debt securities as ordinary income at the time you receive the interest or when it accrues, depending on your method of accounting for tax purposes.

Original Issue Discount

General. If you own a debt security, other than a short-term debt security with a term of one year or less, it will be treated as a discount debt security issued at an original issue discount if the debt security's stated redemption price at maturity exceeds its issue price by more than a *de minimis* amount. Generally, a debt security's issue price will be the first price at which a substantial amount of debt securities included in the issue of which the debt security is a part is sold to persons other than bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers. A debt security's stated redemption price at maturity is the total of all payments provided by the debt security that are not payments of qualified stated interest. Generally, an interest payment on a debt security is qualified stated interest if it is one of a series of stated interest payments on a debt security that are unconditionally payable at least annually at a single fixed rate, with certain exceptions for lower rates paid during some periods, applied to the outstanding principal amount of the debt security. There are special rules for variable rate debt securities that are discussed under " – Variable Rate Debt Securities".

In general, your debt security is not a discount debt security if the amount by which its stated redemption price at maturity exceeds its issue price is less than the *de minimis* amount of $^1/_4$ of 1 percent of its stated redemption price at maturity multiplied by the number of complete years to its maturity. Your debt security will have *de minimis* original issue discount if the amount of the excess is less than the *de minimis* amount. If your debt security has *de minimis* original issue discount, you must include the *de minimis* amount in income as stated principal payments are made on the debt security, unless you make the election described below under " – Election to Treat All Interest as Original Issue Discount". You can determine the includible amount with respect to each such payment by multiplying the total amount of your debt security's *de minimis* original issue discount by a fraction equal to:

- the amount of the principal payment made divided by:
- the stated principal amount of the debt security.

Generally, if your discount debt security matures more than one year from its date of issue, you must include original issue discount, or OID in income before you receive cash attributable to that income. The amount of OID that you must include in income is calculated using a constant-yield method, and generally you will include increasingly greater amounts of OID in income over the life of your debt security. More specifically, you can calculate the amount of OID that you must include in income by adding the daily portions of OID with respect to your discount debt security for each day during the taxable year or portion of the taxable year that you hold your discount debt security. You can determine the daily

Table of Contents

portion by allocating to each day in any accrual period a pro rata portion of the OID allocable to that accrual period. You may select an accrual period of any length with respect to your discount debt security and you may vary the length of each accrual period over the term of your discount debt security. However, no accrual period may be longer than one year and each scheduled payment of interest or principal on the discount debt security must occur on either the first or final day of an accrual period.

You can determine the amount of OID allocable to an accrual period by:

- multiplying your discount debt security's adjusted issue price at the beginning of the accrual period by your debt security's yield to maturity, and then
- subtracting from this figure the sum of the payments of qualified stated interest on your debt security allocable to the accrual period.

You must determine the discount debt security's yield to maturity on the basis of compounding at the close of each accrual period and adjusting for the length of each accrual period. Further, you determine your discount debt security's adjusted issue price at the beginning of any accrual period by:

- adding your discount debt security's issue price and any accrued OID for each prior accrual period, and then
- subtracting any payments previously made on your discount debt security that were not qualified stated interest payments.

If an interval between payments of qualified stated interest on your discount debt security contains more than one accrual period, then, when you determine the amount of OID allocable to an accrual period, you must allocate the amount of qualified stated interest payable at the end of the interval, including any qualified stated interest that is payable on the first day of the accrual period immediately following the interval, pro rata to each accrual period in the interval based on their relative lengths. In addition, you must increase the adjusted issue price at the beginning of each accrual period in the interval by the amount of any qualified stated interest that has accrued prior to the first day of the accrual period but that is not payable until the end of the interval. You may compute the amount of OID allocable to an initial short accrual period by using any reasonable method if all other accrual periods, other than a final short accrual period, are of equal length.

The amount of OID allocable to the final accrual period is equal to the difference between:

- the amount payable at the maturity of your debt security, other than any payment of qualified stated interest, and
- your debt security's adjusted issue price as of the beginning of the final accrual period.

Acquisition Premium. If you purchase your debt security for an amount that is less than or equal to the sum of all amounts, other than qualified stated interest, payable on your debt security after the purchase date but is greater than the amount of your debt security's adjusted issue price, as determined above under " – General", the excess is acquisition premium. If you do not make the election described below under " – Election to Treat All Interest as Original Issue Discount", then you must reduce the daily portions of OID by a fraction equal to:

- the excess of your adjusted basis in the debt security immediately after purchase over the adjusted issue price of the debt security

divided by:

- the excess of the sum of all amounts payable, other than qualified stated interest, on the debt security after the purchase date over the debt security's adjusted issue price.

Pre-Issuance Accrued Interest. An election may be made to decrease the issue price of your debt security by the amount of pre-issuance accrued interest if:

- a portion of the initial purchase price of your debt security is attributable to pre-issuance accrued interest,
- the first stated interest payment on your debt security is to be made within one year of your debt security's issue date, and
- the payment will equal or exceed the amount of pre-issuance accrued interest.

Table of Contents

If this election is made, a portion of the first stated interest payment will be treated as a return of the excluded pre-issuance accrued interest and not as an amount payable on your debt security.

Debt Securities Subject to Contingencies, Including Optional Redemption. Your debt security is subject to a contingency if it provides for an alternative payment schedule or schedules applicable upon the occurrence of a contingency or contingencies, other than a remote or incidental contingency, whether such contingency relates to payments of interest or of principal. In such a case, you must determine the yield and maturity of your debt security by assuming that the payments will be made according to the payment schedule most likely to occur if:

- the timing and amounts of the payments that comprise each payment schedule are known as of the issue date, and
- one of such schedules is significantly more likely than not to occur.

If there is no single payment schedule that is significantly more likely than not to occur, other than because of a mandatory sinking fund, you must include income on your debt security in accordance with the general rules that govern contingent payment obligations. If applicable, these rules will be discussed in the prospectus supplement.

Notwithstanding the general rules for determining yield and maturity, if your debt security is subject to contingencies, and either you or we have an unconditional option or options that, if exercised, would require payments to be made on the debt security under an alternative payment schedule or schedules, then:

- in the case of an option or options that we may exercise, we will be deemed to exercise or not to exercise an option or combination of options in the manner that minimizes the yield on your debt security, and,
- in the case of an option or options that you may exercise, you will be deemed to exercise or not to exercise an option or combination of options in the manner that maximizes the yield on your debt security.

If both you and we hold options described in the preceding sentence, those rules will apply to each option in the order in which they may be exercised. You may determine the yield on your debt security for the purposes of those calculations by using any date on which your debt security may be redeemed or repurchased as the maturity date and the amount payable on the date that you chose in accordance with the terms of your debt security as the principal amount payable at maturity.

If a contingency, including the exercise of an option, actually occurs or does not occur contrary to an assumption made according to the above rules then, except to the extent that a portion of your debt security is repaid as a result of this change in circumstances and solely to determine the amount and accrual of OID, you must redetermine the yield and maturity of your debt security by treating your debt security as having been retired and reissued on the date of the change in circumstances for an amount equal to your debt security's adjusted issue price on that date.

Election to Treat All Interest as Original Issue Discount. You may elect to include in gross income all interest that accrues on your debt security using the constant-yield method described above under " – General", with the modifications described below. For purposes of this election, interest will include stated interest, OID, *de minimis* original issue discount, market discount, *de minimis* market discount and unstated interest, as adjusted by any amortizable bond premium, described below under " – Debt Securities Purchased at a Premium," or acquisition premium.

If you make this election for your debt security, then, when you apply the constant-yield method:

- the issue price of your debt security will equal your cost,
- the issue date of your debt security will be the date you acquired it, and
- no payments on your debt security will be treated as payments of qualified stated interest.

Generally, this election will apply only to the debt security for which you make it; however, if the debt security has amortizable bond premium, you will be

Table of Contents

deemed to have made an election to apply amortizable bond premium against interest for all debt instruments with amortizable bond premium, other than debt instruments the interest on which is excludible from gross income, that you hold as of the beginning of the taxable year to which the election applies or any taxable year thereafter. Additionally, if you make this election for a market discount note, you will be treated as having made the election discussed below under "—Market Discount" to include market discount in income currently over the life of all debt instruments that you currently own or later acquire. You may not revoke any election to apply the constant-yield method to all interest on a debt security or the deemed elections with respect to amortizable bond premium or market discount debt securities without the consent of the Internal Revenue Service.

Variable Rate Debt Securities. Your debt security will be a variable rate debt security if:

- your debt security's issue price does not exceed the total noncontingent principal payments by more than the lesser of:
- 1.5 percent of the product of the total noncontingent principal payments and the number of complete years to maturity from the issue date, or
- 15 percent of the total noncontingent principal payments; and
- your debt security provides for stated interest, compounded or paid at least annually, only at:
- one or more qualified floating rates,
- a single fixed rate and one or more qualified floating rates,
- a single objective rate, or
- a single fixed rate and a single objective rate that is a qualified inverse floating rate.

Your debt security will have a variable rate that is a qualified floating rate if:

- variations in the value of the rate can reasonably be expected to measure contemporaneous variations in the cost of newly borrowed funds in the currency in which your debt security is denominated; or
- the rate is equal to such a rate multiplied by either:
- a fixed multiple that is greater than 0.65 but not more than 1.35 or
- a fixed multiple greater than 0.65 but not more than 1.35, increased or decreased by a fixed rate; and
- the value of the rate on any date during the term of your debt security is set no earlier than three months prior to the first day on which that value is in effect and no later than one year following that first day.

If your debt security provides for two or more qualified floating rates that are within 0.25 percentage points of each other on the issue date or can reasonably be expected to have approximately the same values throughout the term of the debt security, the qualified floating rates together constitute a single qualified floating rate.

Your debt security will not have a qualified floating rate, however, if the rate is subject to certain restrictions (including caps, floors, governors, or other similar restrictions) unless such restrictions are fixed throughout the term of the debt security or are not reasonably expected to significantly affect the yield on the debt security.

Your debt security will have a variable rate that is a single objective rate if:

- the rate is not a qualified floating rate,
- the rate is determined using a single, fixed formula that is based on objective financial or economic information that is not within the control of or unique to the circumstances of the issuer or a related party, and
- the value of the rate on any date during the term of your debt security is set no earlier than three months prior to the first day on which that value is in effect and no later than one year following that first day.

Your debt security will not have a variable rate that is an objective rate, however, if it is reasonably expected that the average value of the rate during the first half of your debt security's term will be either

Table of Contents

significantly less than or significantly greater than the average value of the rate during the final half of your debt security's term.

An objective rate as described above is a qualified inverse floating rate if:

- the rate is equal to a fixed rate minus a qualified floating rate and
- the variations in the rate can reasonably be expected to inversely reflect contemporaneous variations in the cost of newly borrowed funds.

Your debt security will also have a single qualified floating rate or an objective rate if interest on your debt security is stated at a fixed rate for an initial period of one year or less followed by either a qualified floating rate or an objective rate for a subsequent period, and either:

- the fixed rate and the qualified floating rate or objective rate have values on the issue date of the debt security that do not differ by more than 0.25 percentage points or
- the value of the qualified floating rate or objective rate is intended to approximate the fixed rate.

In general, if your variable rate debt security provides for stated interest at a single qualified floating rate or objective rate, or one of those rates after a single fixed rate for an initial period, all stated interest on your debt security is qualified stated interest. In this case, the amount of OID, if any, is determined by using, in the case of a qualified floating rate or qualified inverse floating rate, the value as of the issue date of the qualified floating rate or qualified inverse floating rate, or, for any other objective rate, a fixed rate that reflects the yield reasonably expected for your debt security.

If your variable rate debt security does not provide for stated interest at a single qualified floating rate or a single objective rate, and also does not provide for interest payable at a fixed rate other than a single fixed rate for an initial period, you generally must determine the interest and OID accruals on your debt security by:

- determining a fixed rate substitute for each variable rate provided under your variable rate debt security,
- constructing the equivalent fixed rate debt instrument, using the fixed rate substitute described above,
- determining the amount of qualified stated interest and OID with respect to the equivalent fixed rate debt instrument, and
- adjusting for actual variable rates during the applicable accrual period.

When you determine the fixed rate substitute for each variable rate provided under the variable rate debt security, you generally will use the value of each variable rate as of the issue date or, for an objective rate that is not a qualified inverse floating rate, a rate that reflects the reasonably expected yield on your debt security.

If your variable rate debt security provides for stated interest either at one or more qualified floating rates or at a qualified inverse floating rate, and also provides for stated interest at a single fixed rate other than at a single fixed rate for an initial period, you generally must determine interest and OID accruals by using the method described in the previous paragraph. However, your variable rate debt security will be treated, for purposes of the first three steps of the determination, as if your debt security had provided for a qualified floating rate, or a qualified inverse floating rate, rather than the fixed rate. The qualified floating rate, or qualified inverse floating rate, that replaces the fixed rate must be such that the fair market value of your variable rate debt security as of the issue date approximates the fair market value of an otherwise identical debt instrument that provides for the qualified floating rate, or qualified inverse floating rate, rather than the fixed rate.

Short-Term Debt Securities. In general, if you are an individual or other cash basis United States holder of a short-term debt security, you are not required to accrue OID, as specially defined below for the purposes of this paragraph, for United States federal income tax purposes unless you elect to do so (although it is possible that you may be required to include any stated interest in income as you receive it). If you are an accrual basis taxpayer, a taxpayer in a special class, including, but not limited to, a regulated investment company, common trust fund, or a certain type of pass-through entity, or a cash basis taxpayer who so elects, you will be required to

Table of Contents

accrue OID on short-term debt securities on either a straight-line basis or under the constant-yield method, based on daily compounding. If you are not required and do not elect to include OID in income currently, any gain you realize on the sale or retirement of your short-term debt security will be ordinary income to the extent of the accrued OID, which will be determined on a straight-line basis unless you make an election to accrue the OID under the constant-yield method, through the date of sale or retirement. However, if you are not required and do not elect to accrue OID on your short-term debt securities, you will be required to defer deductions for interest on borrowings allocable to your short-term debt securities in an amount not exceeding the deferred income until the deferred income is realized.

When you determine the amount of OID subject to these rules, you must include all interest payments on your short-term debt security, including stated interest, in your short-term debt security's stated redemption price at maturity.

Market Discount

You will be treated as if you purchased your debt security, other than a short-term debt security, at a market discount, and your debt security will be a market discount debt security if:

- you purchase your debt security for less than its issue price as determined above under "Original Issue Discount – General" and
- the difference between the debt security's stated redemption price at maturity or, in the case of a discount debt security, the debt security's revised issue price, and the price you paid for your debt security is equal to or greater than $^1/_4$ of 1 percent of your debt security's stated redemption price at maturity or revised issue price, respectively, multiplied by the number of complete years to the debt security's maturity. To determine the revised issue price of your debt security for these purposes, you generally add any OID that has accrued on your debt security to its issue price.

If your debt security's stated redemption price at maturity or, in the case of a discount debt security, its revised issue price, exceeds the price you paid for the debt security by less than $^1/_4$ of 1 percent multiplied by the number of complete years to the debt security's maturity, the excess constitutes *de minimis* market discount, and the rules discussed below are not applicable to you.

You must treat any gain you recognize on the maturity or disposition of your market discount debt security as ordinary income to the extent of the accrued market discount on your debt security. Alternatively, you may elect to include market discount in income currently over the life of your debt security. If you make this election, it will apply to all debt instruments with market discount that you acquire on or after the first day of the first taxable year to which the election applies. You may not revoke this election without the consent of the Internal Revenue Service. If you own a market discount debt security and do not make this election, you will generally be required to defer deductions for interest on borrowings allocable to your debt security in an amount not exceeding the accrued market discount on your debt security until the maturity or disposition of your debt security.

You will accrue market discount on your market discount debt security on a straight-line basis unless you elect to accrue market discount using a constant-yield method. If you make this election, it will apply only to the debt security with respect to which it is made and you may not revoke it.

Debt Securities Purchased at a Premium

If you purchase your debt security for an amount in excess of its principal amount, you may elect to treat the excess as amortizable bond premium. If you make this election, you will reduce the amount required to be included in your income each year with respect to interest on your debt security by the amount of amortizable bond premium allocable to that year, based on your debt security's yield to maturity. If you make an election to amortize bond premium, it will apply to all debt instruments, other than debt instruments the interest on which is excludible from gross income, that you hold at the beginning of the first taxable year to which the election applies or that you thereafter acquire, and you may not revoke it without the consent of the Internal Revenue Service. See also "Original Issue Discount – Election to Treat All Interest as Original Issue Discount".

Table of Contents

Purchase, Sale and Retirement of the Debt Securities

Your tax basis in your debt security will generally be your cost of your debt security adjusted by:

- adding any OID or market discount, *de minimis* original issue discount and *de minimis* market discount previously included in income with respect to your debt security, and then
- subtracting any payments on your debt security that are not qualified stated interest payments and any amortizable bond premium applied to reduce interest on your debt security.

You will generally recognize gain or loss on the sale or retirement of your debt security equal to the difference between the amount you realize on the sale or retirement and your tax basis in your debt security.

You will recognize capital gain or loss when you sell or retire your debt security, except to the extent:

- described above under " – Original Issue Discount – Short-Term Debt Securities" or " – Market Discount"
- attributable to accrued but unpaid interest, or
- the rules governing contingent payment obligations apply.

Capital gain of a noncorporate United States holder that is recognized before January 1, 2009 is generally taxed at a maximum rate of 15% where the holder has a holding period of greater than one year.

Indexed Debt Securities

The applicable prospectus supplement will discuss any special United States federal income tax rules with respect to debt securities the payments on which are determined by reference to any index and other debt securities that are subject to the rules governing contingent payment obligations which are not subject to the rules governing variable rate debt securities.

Taxation of Preference Shares and ADSs

Dividends. Under the United States federal income tax laws, if you are a U.S. holder, the gross amount of any dividend paid by us out of our current or accumulated earnings and profits (as determined for United States federal income tax purposes) is subject to United States federal income taxation. If you are a noncorporate U.S. holder, dividends paid to you in taxable years beginning before January 1, 2009 that constitute qualified dividend income will be taxable to you at a maximum tax rate of 15% provided that you hold the shares or ADSs for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date. Dividends we pay with respect to the shares or ADSs generally will be qualified dividend income. If any U.K. tax is withheld from a dividend payment, you must include the amount withheld in this gross amount even though you do not in fact receive it. The dividend is ordinary income that you must include in income when you, in the case of preference shares, or the ADR depositary, in the case of ADSs, receive the dividend, actually or constructively. The dividend will not be eligible for the dividends-received deduction generally allowed to United States corporations in respect of dividends received from other United States corporations. Distributions in excess of current and accumulated earnings and profits, as determined for United States federal income tax purposes, will be treated as a non-taxable return of capital to the extent of your basis in the preference shares or ADSs and thereafter as capital gain.

Subject to certain limitations, if any U.K. tax is withheld in accordance with the Treaty and paid over to the United Kingdom, it will be creditable against your United States federal income tax liability. To the extent a refund of such tax withheld is available to you under U.K. law and under the Treaty, any amount of tax withheld that is refundable will not be eligible for credit against your United States federal income tax liability. Dividends will be income from sources outside the United States. Dividends paid in taxable years beginning before January 1, 2007 generally will be "passive" or "financial services" income, and dividends paid in taxable years beginning after December 31, 2006 will, depending on your circumstances, be "passive" or "general" income which, in either case, is treated separately from other types of income for purposes of computing the foreign tax credit allowable to you.

Capital Gains. If you are a U.S. holder and you sell or otherwise dispose of your preference shares or ADSs, you will recognize capital gain or loss for United States federal income tax purposes equal to

Table of Contents

the difference between the amount that you realize and your tax basis in your preference shares or ADSs. Capital gain of a noncorporate U.S. holder that is recognized before January 1, 2009 is generally taxed at a maximum rate of 15% where the holder has a holding period of greater than one year. The gain or loss will generally be income or loss from sources within the United States for foreign tax credit limitation purposes.

United States Alien Holders

This subsection describes the tax consequences to a United States alien holder of owning and disposing of debt securities, preference shares or ADSs. Undated Subordinated Debt Securities generally will not be treated as debt securities for United States federal income tax purposes; the United States federal income tax consequences of owning and disposing Undated Subordinated Debt Securities will be discussed in an applicable prospectus supplement. You are a United States alien holder if you are a beneficial owner of a debt security, preference share or ADS and you are, for United States federal income tax purposes:

- a nonresident alien individual,
- a foreign corporation, or
- an estate or trust that in either case is not subject to United States federal income tax on a net income basis on income or gain from a debt security.

If you are a U.S. holder, this subsection does not apply to you.

Interest on Debt Securities. Under United States federal income and estate tax law, and subject to the discussion of backup withholding below, if you are a United States alien holder, interest on a debt security paid to you is exempt from United States federal income tax, including withholding tax, whether or not you are engaged in a trade or business in the United States, unless:

- you are an insurance company carrying on a United States insurance business to which the interest is attributable, within the meaning of the Internal Revenue Code, or
- you have an office or other fixed place of business in the United States to which the interest is attributable and derive the interest in the active conduct of a banking, financing or similar business within the United States.

Dividend on Preference Shares or ADSs. If you are a United States alien holder, dividends paid to you in respect of your preference shares or ADSs will not be subject to United States federal income tax unless the dividends are “effectively connected” with your conduct of a trade or business within the United States, and, if required by an applicable income tax treaty as a condition for subjecting you to United States taxation on a net income basis, the dividends are attributable to a permanent establishment that you maintain in the United States. In such cases you generally will be taxed in the same manner as a U.S. holder. If you are a corporate United States alien holder, “effectively connected” dividends may, under certain circumstances, be subject to an additional “branch profits tax” at a rate of 30 percent or a lower rate if you are eligible for the benefits of an income tax treaty that provides for a lower rate.

Disposition of the Debt Securities, Preference Shares or ADSs. If you are a United States alien holder, you generally will not be subject to United States federal income tax on gain realized on the sale, exchange or retirement of your debt security, preference share or ADS unless:

- the gain is effectively connected with your conduct of a trade or business in the United States, and the gain is attributable to a permanent establishment that you maintain in the United States if that is required by an applicable income tax treaty as a condition for subjecting you to United States taxation on a net income basis, or
- you are an individual, you are present in the United States for 183 or more days during the taxable year in which the gain is realized and certain other conditions exist.

If you are a corporate United States alien holder, “effectively connected” gains that you recognize may also, under certain circumstances, be subject to an additional “branch profits tax” at a 30 percent rate or at a lower rate if you are eligible for the benefits of an income tax treaty that provides for a lower rate.

Table of Contents

Information Reporting and Backup Withholding

If you are a noncorporate United States holder, information reporting requirements, on Internal Revenue Service Form 1099, generally will apply to:

- payments of principal and interest on a debt security and dividends or other taxable distributions with respect to a preference share or an ADS within the United States, including payments made by wire transfer from outside the United States to an account you maintain in the United States, and
- the payment of the proceeds from the sale of a debt security, preference share or ADS effected at a United States office of a broker.

Additionally, backup withholding will apply to such payments if you are a noncorporate U. S. holder that:

- fails to provide an accurate taxpayer identification number, is notified by the Internal Revenue Service that you have failed to report all interest and dividends required to be shown on your federal income tax returns, or
- in certain circumstances, fails to comply with applicable certification requirements.

If you are a United States alien holder, you are generally exempt from backup withholding and information reporting requirements with respect to:

- payments of principal and interest on a debt security or dividends with respect to a preference share or ADS made to you outside the United States by us or another non-United States payor and
- other payments of principal, interest and dividends and the payment of the proceeds from the sale of a debt security, preference share or ADS effected at a United States office of a broker, as long as the income associated with such payments is otherwise exempt from United States federal income tax, and:
  - the payor or broker does not have actual knowledge or reason to know that you are a United States person and you have furnished to the payor or broker:
  - an Internal Revenue Service Form W-8BEN or an acceptable substitute form upon which you certify, under penalties of perjury, that you are a non-United States person, or
  - other documentation upon which it may rely to treat the payments as made to a non-United States person in accordance with U.S. Treasury regulations, or
- you otherwise establish an exemption.

Payment of the proceeds from the sale of a debt security, preference share or ADS effected at a foreign office of a broker generally will not be subject to information reporting or backup withholding. However, a sale of a debt security, preference share or ADS that is effected at a foreign office of a broker will be subject to information reporting and backup withholding if:

- the proceeds are transferred to an account maintained by you in the United States,
- the payment of proceeds or the confirmation of the sale is mailed to you at a United States address, or
- the sale has some other specified connection with the United States as provided in U.S. Treasury regulations,

unless the broker does not have actual knowledge or reason to know that you are a United States person and the documentation requirements described above are met or you otherwise establish an exemption.

In addition, a sale of a debt security, preference share or ADS effected at a foreign office of a broker will be subject to information reporting if the broker is:

- a United States person,
- a controlled foreign corporation for United States tax purposes,

- a foreign person 50% or more of whose gross income is effectively connected with the conduct of a United States trade or business for a specified three-year period, or

Table of Contents

- a foreign partnership, if at any time during its tax year:
- one or more of its partners are "U.S. persons", as defined in U.S. Treasury regulations, who in the aggregate hold more than 50% of the income or capital interest in the partnership, or
- such foreign partnership is engaged in the conduct of a United States trade or business,

unless the broker does not have actual knowledge or reason to know that you are a United States person and the documentation requirements described above are met or you otherwise establish an exemption. Backup withholding will apply if the sale is subject to information reporting and the broker has actual knowledge that you are a United States person.

You generally may obtain a refund of any amounts withheld under the backup withholding rules that exceed your income tax liability by filing a refund claim with the United States Internal Revenue Service.

United Kingdom Taxation

The following paragraphs summarize certain United Kingdom withholding and other tax considerations with respect to the acquisition, ownership and disposition of the debt securities, preference shares and ADSs described in this prospectus by U.S. holders and other non-U.K. resident persons. It is based upon the opinion of Clifford Chance LLP, our United Kingdom solicitors. The summary is based on current United Kingdom law and HM Revenue & Customs practice and the provisions of the Double Taxation Treaty between the United Kingdom and the United States (the "Treaty") which came into force on March 31, 2003, all of which are subject to change at any time, possibly with retrospective effect.

The summary only applies to persons who are the absolute beneficial owner of their debt securities, preference shares or ADSs. References to a "U.S. holder" are to that term as described above under "Tax Considerations – United States Taxation – U.S. Holders". The summary is not comprehensive and does not deal with the position of United Kingdom resident persons or with that of non-U.K. resident persons who carry on a trade, profession or vocation in the United Kingdom through a branch or agency or, in the case of a company, through a permanent establishment through or for the purposes of which their debt securities, preference shares or ADSs are used or held. Additionally the summary may not apply to certain classes of persons, such as dealers in securities.

You should consult your own tax advisors concerning the consequences of acquiring, owning and disposing of debt securities, preference shares and ADSs in your particular circumstances, including the applicability and effect of the Treaty.

Debt Securities

Payments of Interest. If the interest on the debt securities does not have a United Kingdom source, no withholding or deduction for or on account of United Kingdom tax will be made from payments of interest on the debt securities.

Interest on the debt securities may, however, constitute United Kingdom source income for United Kingdom tax purposes. Even if the interest does have a United Kingdom source, the debt securities will constitute "quoted Eurobonds" within the meaning of Section 349 of the Income and Corporation Taxes Act 1988 (the "Taxes Act"), provided they are and continue to be listed on a "recognised stock exchange" within the meaning of Section 841 of the Taxes Act. Accordingly, payments of interest (including payments of premium, if any, to the extent such premium, or any part of such premium, constitutes interest) on the debt securities made by us or any paying agent (or received by any collecting agent) may be made (or received, as the case may be) without withholding or deduction for or on account of United Kingdom income tax provided the debt securities remain listed on a recognised stock exchange at the time of payment.

Interest on debt securities having a maturity of less than one year may also be paid without withholding or deduction for or on account of United Kingdom income tax. In all other cases, unless the interest on the notes is "paid by a bank in the ordinary course of business" within the meaning of Section 349 of the Taxes Act, an amount must be withheld on account of income tax at the lower rate (currently 20%), subject to any direction to the contrary by HM

Table of Contents

Revenue & Customs under an applicable double tax treaty and subject to any entitlement to pay gross to holders of debt securities who are within the charge to United Kingdom corporation tax. Interest will be "paid by a bank in the ordinary course of business" unless either (i) the borrowing in question conforms to any of the definitions of tier 1, 2 or 3 capital adopted by the Financial Services Authority, whether or not it actually counts toward tier 1, 2 or 3 capital for regulatory purposes, or (ii) the characteristics of the transaction giving rise to the interest are primarily attributable to an intention to avoid United Kingdom tax. We are currently a "bank" for the purposes of Section 349 of the Taxes Act.

Interest which has a United Kingdom source may be subject to United Kingdom tax by direct assessment even where such interest is paid without withholding. However, as regards a U.S. holder who is not resident in the United Kingdom for United Kingdom tax purposes, interest paid on the debt securities without withholding will not be subject to United Kingdom tax provided that the relevant U.S. holder does not have a "United Kingdom representative", within the meaning of the Finance Act 1995, through whom the U.S. holder carries on a trade, profession or vocation in the United Kingdom and to which the interest is attributable.

Discount. The profit realized on any disposal (which includes redemption) of any Discount Security may attract United Kingdom withholding tax. However, even if it does not, it may be subject to United Kingdom tax by direct assessment to the same extent as interest which has a United Kingdom source.

Provision of Information. Persons in the United Kingdom paying interest to or receiving interest on behalf of another person may be required to provide certain information to HM Revenue & Customs regarding the identity of the payee or person entitled to the interest and, in certain circumstances, such information may be exchanged with tax authorities in other countries.

In this respect, on June 3, 2003 the council of the European Union (the "Council") adopted EC Council Directive 2003/48/EC regarding the taxation of savings income (the "Directive"). Under the Directive, each Member State of the European Union is required, from July 1, 2005, to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident in that other Member State; however, for a transitional period, Austria, Belgium and Luxembourg may instead apply a withholding system in relation to such payments, deducting tax at rates rising over time to 35 percent. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments.

Also with effect from July 1, 2005, a number of non-EU countries, and certain dependent or associated territories of certain Member States, have agreed to adopt similar measures (either provision of information or transitional withholding) in relation to payments made by a person within its jurisdiction to, or collected by such a person for, an individual resident in a Member State. In addition, the Member States have entered into reciprocal provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident in one of those territories.

Disposal (including Redemption), Accruals and Changes in Value. A holder of debt securities who is neither resident nor (in the case of an individual) ordinarily resident in the United Kingdom will not be liable to United Kingdom taxation in respect of a disposal (including redemption) of a debt security, any gain accrued in respect of a debt security or any change in the value of a debt security unless the holder carries on a trade, profession or vocation in the United Kingdom through a branch or agency or, in the case of a company, through a permanent establishment and the debt security was used in or for the purposes of this trade, profession or vocation or acquired for the use and used by or for the purposes of the branch or agency or permanent establishment.

Inheritance Tax. A holder of debt securities who is an individual domiciled outside the United Kingdom will generally not be liable to United Kingdom inheritance tax in respect of his holding of debt securities. This will be the case if a register of the debt securities is held outside the United Kingdom and the securities are only enforceable outside the United Kingdom. If no register is maintained, there may be a liability to inheritance tax if the debt securities are held or enforceable in the United Kingdom, and this may also be the case if the debt

Table of Contents

securities are registered and the only register which is maintained is maintained in the United Kingdom. If so, exemption from or reduction in any United Kingdom inheritance tax liability may be available for U.S. holders under the Estate Tax Treaty made between the United Kingdom and the United States.

Stamp Duty and Stamp Duty Reserve Tax. No United Kingdom stamp duty or stamp duty reserve tax will generally be payable by a holder of debt securities on the creation, issue or redemption of debt securities.

Subject to certain exceptions (although other exceptions may apply), no liability for United Kingdom stamp duty or stamp duty reserve tax will arise on a transfer of, or an agreement to transfer, debt securities. The exceptions include a security which carries: (i) a right of conversion into shares or other securities or to the acquisition of shares or other securities, including loan capital of the same description, (ii) a right to interest the amount of which exceeds a reasonable commercial return on the nominal amount of the capital, (iii) a right to interest the amount of which falls or has fallen to be determined to any extent by reference to the results of, or of any part of, a business or to the value of any property, or (iv) a right on repayment to an amount which exceeds the nominal amount of the capital and is not reasonably comparable with what is generally repayable (in respect of a similar nominal amount of capital) under the terms of issue of loan capital listed in the Official List of the London Stock Exchange. If one of the exceptions applies so that the transfer or the agreement to transfer is subject to stamp duty or stamp duty reserve tax, the position will be as summarized below in the case of preference shares.

Preference Shares and ADSs

Dividends. No withholding or deduction for or on account of United Kingdom tax will be made from payments of dividends on the preference shares or ADSs.

Subject to the Finance (No. 2) Act 2005 provisions set out below, holders of preference shares or ADSs who are not resident for tax purposes in the United Kingdom and who receive a dividend from ourselves will not have any further United Kingdom tax to pay in respect of the dividend. Such holders will not normally be able to claim any additional payment in respect of the dividend from HM Revenue & Customs under any applicable double tax treaty; in particular, U.S. holders will not be able to claim any additional payment in respect of the dividend from HM Revenue & Customs under the Treaty.

Disposals. Subject to the Finance (No. 2) Act 2005 provisions set out below, shareholders or ADS holders who are neither resident nor (in the case of an individual) ordinarily resident in the United Kingdom will not normally be liable for United Kingdom tax on chargeable gains (or for any other United Kingdom tax upon a disposal or deemed disposal of shares or ADSs) unless they carry on a trade, profession or vocation in the United Kingdom through a branch or agency or, in the case of a company, through a permanent establishment, and the shares or ADSs are or have been used or held by or for the purposes of the branch or agency or permanent establishment, in which case such shareholder or ADS holder might, depending on individual circumstances, be liable to United Kingdom tax on chargeable gains on any disposal (or deemed disposal) of shares or ADSs.

Finance (No 2) Act 2005. On July 20, 2005, the Finance (No 2) Act 2005 (the "Act") was given Royal Assent and passed into law. Under certain provisions included in the Act, it is possible that a holder of preference shares subject to UK corporation tax would be taxed as if its preference shares or ADSs were debt securities. The Act sets out certain circumstances in which the provisions would not apply, such as where the shares concerned are "qualifying publicly issued shares" or where the holder does not hold its shares for a "tax avoidance purpose". There are also certain limited circumstances in which particular holders could fall within the scope of the provisions, even if they held shares which were, or would otherwise be, "qualifying publicly issued shares". No detailed guidance as to the precise scope of the relevant provisions has been published by HM Revenue & Customs as yet. In the event that holders of preference shares or ADSs are subject to UK corporation tax, they should therefore obtain independent advice as to their tax position.

Inheritance Tax. A holder of ADSs who is an individual domiciled outside the United Kingdom will generally not be liable to United Kingdom

Table of Contents

inheritance tax in respect of his holding of ADSs. Such an individual may, however, have a liability to inheritance tax in respect of any holding of preference shares. If so, exemption from or reduction in any United Kingdom inheritance tax liability may be available for U.S. holders of preference shares under the Estate Tax Treaty made between the United Kingdom and the United States.

Stamp Duty and Stamp Duty Reserve Tax. Except in certain limited circumstances, any conveyance or transfer on sale or other disposal of shares will be subject to United Kingdom stamp duty or stamp duty reserve tax. The transfer on sale of shares will generally be liable to ad valorem United Kingdom stamp duty or stamp duty reserve tax, generally at the rate of 0.5% of the consideration paid (rounded up to the next multiple of £5 in the case of stamp duty). Stamp duty is usually the liability of the purchaser or transferee of the shares. An unconditional agreement to transfer such shares will generally be subject to stamp duty reserve tax, generally at the rate of 0.5% of the consideration paid, but such liability will be cancelled, or, if already paid, refunded, if the agreement is completed by a duly stamped transfer within six years of the agreement having become unconditional. Stamp duty reserve tax is normally the liability of the purchaser or transferee of the shares.

Where we issue shares, or a holder of shares transfers such shares, to an ADR issuer, a liability for United Kingdom stamp duty or stamp duty reserve tax at the rate of 1.5% (rounded up to the next multiple of £5 in the case of stamp duty) of either the issue price or, in the case of a transfer, the amount or value of the consideration for the transfer, or the value of the shares, may arise. This liability for United Kingdom stamp duty or stamp duty reserve tax will strictly be the liability of the ADR issuer (or their nominee or agent). However, in practice, (i) where shares are *issued* to an ADR issuer, we will reimburse the ADR issuer or otherwise bear the cost and (ii) where shares are *transferred* to an ADR issuer, the liability for payment of the United Kingdom stamp duty or stamp duty reserve tax will depend on the arrangements in place between the seller, the ADR issuer and the purchaser.

Where we issue shares, or a holder of shares transfers such shares, to a person providing clearance services (or their nominee or agent) and where the person providing clearance services has not made an election under section 97A Finance Act 1986, a liability for United Kingdom stamp duty or stamp duty reserve tax at the rate of 1.5% (rounded up to the next multiple of £5 in the case of stamp duty) of either the issue price or, in the case of a transfer, the amount or value of the consideration for the transfer, or the value of the shares, may arise. This liability for United Kingdom stamp duty or stamp duty reserve tax will strictly be the liability of the person providing clearance services (or their nominee or agent). However, in practice, (i) where shares are *issued* to a person providing clearance services (or their nominee or agent), we will reimburse the person providing clearing services or otherwise bear the cost and (ii) where shares are *transferred* to a person providing clearance services (or their nominee or agent), the liability for payment of the United Kingdom stamp duty or stamp duty reserve tax will depend on the arrangements in place between the seller, the person providing clearance services and the purchaser. Transfers of shares within a clearance system are generally outside the scope of stamp duty as long as there is no instrument of transfer, and are exempt from stamp duty reserve tax.

Where we issue shares, or a holder of shares transfers such shares, to a person providing clearance services (or their nominee or agent), and that person has made an election under section 97A Finance Act 1986, there will be no liability for United Kingdom stamp duty or stamp duty reserve tax at the rate of 1.5% of either the issue price or, in the case of a transfer, the amount or value of the consideration for the transfer, or the value of the shares. However, in such case, a liability for United Kingdom stamp duty or stamp duty reserve tax may arise on the transfer of shares within the clearance system (as set out in the first paragraph under the heading “Stamp Duty and Stamp Duty Reserve Tax”).

Where we issue shares in bearer form that are sterling denominated, we may be liable to stamp duty at the rate of 1.5% of the issue price. In the event that we are so liable, we will pay such stamp duty.

If any ADS are cancelled, with the preference shares that they represent being transferred to the ADS holder, a liability for stamp duty may arise at the fixed rate of £5 on any instrument providing for such transfer of the preference shares.

No liability for stamp duty or stamp duty reserve tax will arise on a transfer of ADSs, provided that any

Table of Contents

document that effects such transfer is not executed in the United Kingdom and that it remains at all subsequent times outside the United Kingdom. An agreement to transfer ADSs will not give rise to a liability for stamp duty reserve tax.

PLAN OF DISTRIBUTION

Initial Offering and Sale of Securities

We may sell all or part of the securities from time to time, in terms determined at that time, through underwriters, dealers and/or agents, directly to purchasers or through a combination of any of these methods of sale. We will set forth in the applicable prospectus supplement:

- the terms of the offering of the securities,
- the names of any underwriters, dealers or agents involved in the sale of the securities,
- the principal amounts of securities any underwriters will purchase,
- any applicable underwriting commissions or discounts which shall be no more than 3% of the proceeds from the offering, and
- our net proceeds.

If we use underwriters in the sale, they will acquire the securities for their own account and they may effect distribution of the securities from time to time in one or more transactions. These transactions may be at a fixed price or prices, which they may change, or at prevailing market prices, or related to prevailing market prices, or at negotiated prices. The securities may be offered to the public either through underwriting syndicates represented by managing underwriters or underwriters without a syndicate. Unless the applicable prospectus supplement specifies otherwise, the underwriters' obligations to purchase the securities will depend on certain conditions being satisfied. If the conditions are satisfied the underwriters will be obligated to purchase all of the securities of the series, if they purchase any of them. The initial public offering price of any securities and any discounts or concessions allowed or reallowed or paid to dealers may change from time to time.

If we use dealers in the sale, unless the applicable prospectus supplement specifies otherwise, we will sell the securities to the dealers as principals. The dealers may then resell the securities to the public at varying prices that the dealers will determine at the time of resale.

We may also sell securities through agents we designate from time to time, or we may sell securities directly. The applicable prospectus supplement will name any agent involved in the offering and sale of the securities, and will also set forth any commissions that we will pay. Unless the applicable prospectus supplement indicates otherwise, any agent will be acting on a best efforts basis for the period of its appointment. Agents through whom we sell securities may enter into arrangements with other institutions with respect to the distribution of the securities, and those institutions may share in the commissions, discounts or other compensation received by our agents, may be compensated separately and may also receive commissions from the purchasers for whom they may act as agents.

In connection with the sale of securities, underwriters may receive compensation from us or from purchasers of securities for whom they may act as agents. Compensation may be in the form of discounts, concessions or commissions. Underwriters may sell securities to or through dealers, and these dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters. Dealers may also receive commissions from the purchasers for whom they may act as agents. Underwriters, dealers and agents that participate in the distribution of securities may be deemed to be underwriters, and any discounts or commissions received by them from us and any profit on the resale of securities by them may be deemed to be underwriting discounts and commissions under the Securities Act. The prospectus supplement will identify any underwriter or agent, and describe any compensation that we provide.

If the applicable prospectus supplement so indicates, we will authorize underwriters, dealers or agents to solicit offers to purchase the securities from institutional investors. In this case, the prospectus supplement will also indicate on what date payment and delivery will be made. There may be a minimum amount which an institutional investor may purchase, or a minimum portion of the aggregate principal

Table of Contents

amount of the securities which may be sold by this type of arrangement. Institutional investors may include commercial and savings banks, insurance companies, pension funds, investment companies, educational and charitable institutions and any other institutions we may approve. The purchasers' obligations under delayed delivery and payment arrangements will not be subject to any conditions; however, the institutional investors' purchase of particular securities must not at the time of delivery be prohibited under the laws of any relevant jurisdiction in respect, either of the validity of the arrangements, or the performance by us or the institutional investors under the arrangements.

We may enter into agreements with the underwriters, dealers and agents who participate in the distribution of the securities that may fully or partially indemnify them against some civil liabilities, including liabilities under the Securities Act. Underwriters, dealers and agents may be customers of, engage in transactions with, or perform services for, or be affiliates of Barclays PLC and the Barclays Bank Group in the ordinary course of business.

Barclays Capital Inc. is a subsidiary of Barclays PLC and may participate in one or more offerings of our securities. Rule 2720 of the Conduct Rules of the National Association of Securities Dealers, Inc. imposes certain requirements when an NASD member such as Barclays Capital Inc. distributes an affiliated company's securities, such as those of Barclays Bank PLC. Barclays Capital Inc. has advised us that each particular offering of securities in which it participates will comply with the applicable requirements of Rule 2720.

Barclays Capital Inc. will not confirm initial sales to accounts over which it exercises discretionary authority without the prior written approval of the customer.

Selling Restrictions

Unless the applicable prospectus supplement specifies otherwise, we will not offer the securities or any investments representing securities, including ADSs or ADRs, of any series to the public in the United Kingdom or any member state of the European Economic Area ("EEA") which has implemented Directive 2003/71/EC (the "Prospectus Directive").

United Kingdom

Unless otherwise specified in any agreement between us and the underwriters, dealers and/or agents in relation to the distribution of the securities or any investments representing securities, including ADSs or ADRs, of any series and subject to the terms specified in the agreement, any underwriter, dealer or agent in connection with an offering of securities or any investments representing securities, including ADSs or ADRs, of any series will confirm and agree that:

- it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of any securities or any investments representing securities, including ADSs or ADRs, in circumstances in which Section 21(1) of the FSMA would not, if we were not an "authorized person" under the FSMA, apply to us; and

- it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the securities, or any investments representing securities, including ADSs and ADRs in, from or otherwise involving the United Kingdom.

European Economic Area

Unless otherwise specified in any agreement between us and the underwriters, dealers and/or agents in relation to the distribution of the securities or any investments representing securities, including ADSs or ADRs, of any series and subject to the terms specified in the agreement, any underwriter, dealer or agent in connection with an offering of securities or any investments representing securities, including ADSs or ADRs, of any series will confirm and agree that with effect from and including the date on which the Prospectus Directive is implemented in a member state of the EEA it has not made and will not make an offer of any securities or any investments representing securities to the public in the relevant member state except that it may, as of the date on

Table of Contents

which the Prospectus Directive is implemented in such member state, make an offer of the securities to the public in such member state:

- in (or in Germany, where the offer starts within) the period beginning on the date of publication of a prospectus in relation to such securities which has been approved by the competent authority in the relevant member state or, where appropriate, approved in another member state and notified to the competent authority in the relevant member state, all in accordance with the Prospectus Directive and ending on the date which is 12 months after the date of such publication;
- at any time to legal entities which are authorized or regulated to operate in the financial markets or, if not so authorized or regulated, whose corporate purpose is solely to invest in securities;
- at any time to any legal entity which has two or more of (i) an average of at least 250 employees during the last financial year; (ii) a total balance sheet of more than €43,000,000 and (iii) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts; or
- at any time in any other circumstances which do not require the publication by us of a prospectus pursuant to Article 3 of the Prospectus Directive.

The expression an "an offer of any securities or any investments representing securities to the public" in relation to such securities or investments in any member state means the communication in any form and by any means of sufficient information on the terms of the offer and the securities or investments to be offered so as to enable an investor to decide to purchase the securities or investments, as the same may be varied in the relevant member state by any measure implementing the Prospectus Directive in that member state.

Market-Making Resales

This prospectus may be used by Barclays Capital Inc. in connection with offers and sales of the securities in market-making transactions. In a market-making transaction, Barclays Capital Inc. may resell a security it acquires from other holders, after the original offering and sale of the security. Resales of this kind may occur in the open market or may be privately negotiated, at prevailing market prices at the time of resale or at related or negotiated prices. In these transactions, Barclays Capital Inc. may act as principal, or agent, including as agent for the counterparty in a transaction in which Barclays Capital Inc. acts as principal, or as agent for both counterparties in a transaction in which Barclays Capital Inc. does not act as principal. Barclays Capital Inc. may receive compensation in the form of discounts and commissions, including from both counterparties in some cases. Other affiliates of Barclays Bank PLC may also engage in transactions of this kind and may use this prospectus for this purpose.

The aggregate initial offering price specified on the cover of the accompanying prospectus supplement relates to the initial offering of the securities described in the prospectus supplement. This amount does not include securities sold in market-making transactions. The latter include securities to be issued after the date of this prospectus, as well as securities previously issued.

Barclays Bank PLC may receive, directly or indirectly, all or a portion of the proceeds of any market making transactions by Barclays Capital Inc. and its other affiliates.

Information about the trade and settlement dates, as well as the purchase price, for a market-making transaction will be provided to the purchaser in a separate confirmation of sale.

Unless we or an agent informs you in your confirmation of sale that your security is being purchased in its original offering and sale, you may assume that you are purchasing your security in a market-making transaction.

Matters Relating to Initial Offering and Market-Making Resales

Each series of securities will be a new issue, and there will be no established trading market for any security prior to its original issue date. We may choose not to list a particular series of securities on a securities exchange or quotation system. We have

Table of Contents

been advised by Barclays Capital Inc. that it intends to make a market in the securities, and any underwriters to whom we sell securities for public offering or broker-dealers may also make a market in those securities. However, neither Barclays Capital Inc. nor any underwriter or broker-dealer that makes a market is obligated to do so, and any of them may stop doing so at any time without notice. We cannot give any assurance as to the liquidity of the trading market for the securities.

Unless otherwise indicated in the applicable prospectus supplement or confirmation of sale, the purchase price of the securities will be required to be paid in immediately available funds in New York City.

In this prospectus or any accompanying prospectus supplement, the terms “this offering” means the initial offering of securities made in connection with their original issuance. This term does not refer to any subsequent resales of securities in market-making transactions.

SERVICE OF PROCESS AND ENFORCEMENT OF LIABILITIES

We are an English public limited company. Substantially all of our directors and executive officers and a number of the experts named in this document are non-residents of the United States. All or a substantial portion of the assets of those persons are located outside the United States. Most of our assets are located outside of the United States. As a result, it may not be possible for you to effect service of process within the United States upon those persons or to enforce against them judgments of U.S. courts based upon the civil liability provisions of the federal securities laws of the United States. We have been advised by our English solicitors, Clifford Chance LLP, that there is doubt as to the enforceability in the United Kingdom, in original actions or in actions for enforcement of judgments of U.S. courts, of liabilities based solely upon the federal securities laws of the United States.

WHERE YOU CAN FIND MORE INFORMATION

We are subject to the information requirements of the Exchange Act. Accordingly, we file jointly with Barclays PLC, reports and other information with the SEC.

The SEC maintains an internet site at *http://www.sec.gov* that contains reports and other information we file electronically with the SEC. You may also inspect and copy reports and other information that we file with the SEC at the public reference facilities maintained at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. Copies of such material may be obtained by mail from the Public Reference Section of the SEC at 100 F Street, NE, Room 1580, Washington D.C. 20549 at prescribed rates. In addition, you may inspect and copy that material at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005, on which some of our securities are listed.

We will furnish to the debt trustee and the warrant trustee referred to under “Description of Debt Securities” and “Description of Warrants” annual reports, which will include a description of operations and annual audited consolidated financial statements prepared in accordance with IFRS, together with a reconciliation of consolidated net income and consolidated ordinary shareholders’ equity to estimated amounts in accordance with U.S. GAAP. We will also furnish the debt trustee and the warrant trustee with interim reports that will include unaudited interim summary consolidated financial information prepared in accordance with IFRS. If we choose to do so, those interim reports may contain a reconciliation of consolidated net income and consolidated ordinary shareholders’ equity to estimated amounts in accordance with U.S. GAAP. We will furnish the debt trustee and the warrant trustee, as applicable, with all notices of meetings at which holders of securities are entitled to vote, and all other reports and communications that are made generally available to those holders.

Table of Contents

FURTHER INFORMATION

We have filed with the SEC a registration statement on Form F-3 with respect to the securities offered with this prospectus. This prospectus is a part of that registration statement and it omits some information that is contained in the registration statement. You can access the registration statement together with exhibits on the internet site maintained by the SEC at *http://www.sec.gov* or inspect these documents at the offices of the SEC in order to obtain that additional information about us and about the securities offered with this prospectus.

VALIDITY OF SECURITIES

If stated in the prospectus supplement applicable to a specific issuance of debt securities or warrants, the validity of the securities under New York law may be passed upon for us by our United States counsel, Sullivan & Cromwell LLP. If stated in the prospectus supplement applicable to a specific issuance of debt securities or warrants, the validity of the securities under English law may be passed upon by our English solicitors, Clifford Chance LLP. Sullivan & Cromwell LLP may rely on the opinion of Clifford Chance LLP as to all matters of English law and Clifford Chance LLP may rely on the opinion of Sullivan & Cromwell LLP as to all matters of New York law. If this prospectus is delivered in connection with an underwritten offering, the validity of the debt securities and the warrants may be passed upon for the underwriters by United States and English counsel for the underwriters specified in the related prospectus supplement. If no English counsel is specified, such United States counsel to the underwriters may also rely on the opinion of Clifford Chance LLP as to certain matters of English law.

EXPERTS

PricewaterhouseCoopers LLP, Chartered Accountants and Registered Auditors, have audited our consolidated financial statements included in the 2004 Form 20-F, as amended, and incorporated by reference in this document and the Registration Statement. We have incorporated the consolidated financial statements in reliance on the report of PricewaterhouseCoopers LLP, Chartered Accountants and Registered Auditors, given on the authority of their firm as experts in auditing and accounting.

EXPENSES OF ISSUANCE AND DISTRIBUTION

The following are the estimated expenses, other than any underwriting discounts and commission and expenses reimbursed by us, to be incurred in connection with the issuance and distribution of the securities registered under the registration statement of which this prospectus forms a part:

Securities and Exchange Commission registration fee	$	1,101,756
NASD fee		75,500
Printing and engraving expenses		30,000
Legal fees and expenses		3,000,000
Accountants' fees and expenses		150,000
Trustee fees and expenses		150,000
ADR Depositary's fees and expenses		50,000
Miscellaneous		30,000
Total	$	4,587,256

Table of Contents

$250,000,000

BARCLAYS BANK PLC

iPath℠ EUR/USD Exchange Rate ETN

MEDIUM-TERM NOTES, SERIES A

Pricing Supplement

May 8, 2007

**(to Prospectus dated September 21, 2005 and
Prospectus Supplement dated November 1, 2006)**

Patent Pending

BCY-F-106-05BK7

Disclosure of Loss Reportable Transactions

Congress has enacted a series of income tax laws designed to halt the growth of abusive tax avoidance transactions. These provisions include the **disclosure of reportable transactions**. Each taxpayer that has participated in a reportable transaction and that is required to file a tax return must disclose information for each reportable transaction in which the taxpayer participates. Use Form 8886 to disclose information for each reportable transaction in which participation has occurred. Generally, Form 8886 must be attached to the tax return for each tax year in which participation in a reportable transaction has occurred. If a transaction is identified as a listed transaction or transaction of interest after the filing of a tax return (including amended returns), the transaction must be disclosed either within 90 days of the transaction being identified as a listed transaction or a transaction of interest or with the next filed return, depending on which version of the regulations is applicable. See the regulations under section 1.6011-4 for more information.

Material advisors with respect to any reportable transaction must also disclose information about the transaction on Form 8918. This requirement applies to material advisors who provide material aid, assistance, or advice on any reportable transaction after October 22, 2004.

One reportable transaction that must be disclosed is a loss transaction.

Losses that must be reported on Forms 8886 and 8918

If a taxpayer claims a loss under § 165 of at least one of the following amounts on a tax return, then the taxpayer has participated in a loss transaction and must file Form 8886. If an advisor provides material aid, assistance, or advice on a transaction that results in a taxpayer claiming a § 165 loss of at least one of the following amounts and meets other filing requirements; then the advisor is a material advisor and must file Form 8918.

- For individuals, at least $2 million in a single tax year or $4 million in any combination of tax years.
- For corporations (excluding S corporations), at least $10 million in any single tax year or $20 million in any combination of tax years.
- For partnerships with only corporations (excluding S corporations) as partners (looking through any partners that are also partnerships), at least $10 million in any single tax year or $20 million in any combination of tax years, whether or not any losses flow through to one or more partners.
- For all other partnerships and S corporations, at least $2 million in any single tax year or $4 million in any combination of tax years, whether or not any losses flow through to one or more partners or shareholders.
- For trusts, at least $2 million in any single tax year or $4 million in any combination of tax years, whether of not any losses flow through to one or more beneficiaries.
- A loss from a foreign currency transaction under Internal Revenue Code section 988 is a loss transaction if the gross amount of the loss is at least $50,000 in a single tax year for individuals or trusts, whether or not the loss flows through from an S corporation or partnership.

Taxpayers whose filed return does not reflect a section 165 loss that equals or exceeds the applicable threshold amount have not participated in a loss transaction. If you are a partner, shareholder, or beneficiary of a pass-through entity, you have participated in a loss transaction if your tax return reflects a section 165 loss allocable to it from the pass-through entity that equals or exceeds the applicable threshold amount.

Losses that do not have to be reported on Forms 8886 and 8918:

- Losses from casualties, thefts, and condemnations
- Losses from Ponzi Schemes
- Losses from the sale or exchange of an asset with a qualifying basis
- Losses arising from any mark-to-market treatment of an item
- Certain Swap losses (see Notice 2006-16)

For additional information on losses that do not have to be reported on Form 8886, see Revenue Procedure 2004-66 and Revenue Ruling 2009-9.

Page Last Reviewed or Updated: 07-Mar-2016

Requirements for Filing Form 8886 - Questions and Answers

#	Questions	Answers
1.	Who must file a Form 8886, Reportable Transaction Disclosure Statement?	Any taxpayer, including an individual, trust, estate, partnership, S corporation, or other corporation, that participates in a reportable transaction and is required to file a federal tax return or information return must file Form 8886 disclosing the transaction. The filing requirement applies whether or not another party, related or otherwise, has filed a disclosure for that transaction.

2.	How does a taxpayer disclose its participation in a reportable transaction?	The taxpayer must attach a Form 8886 disclosure statement to each tax return reflecting participation in the reportable transaction. The taxpayer must also send a copy of the Form 8886 to the Office of Tax Shelter Analysis (OTSA). See Treasury Regulation § 1.6011-4(e)(1) and Form 8886 instructions. In addition, the taxpayer must file a disclosure statement if a transaction becomes a listed transaction or transaction of interest (TOI) after the filing of the taxpayer's tax return (including an amended return), if the period of limitation for assessment on the tax return has not expired. The Form 8886 must reflect either tax consequences or a tax strategy described in the published guidance listing the transaction or designating the transaction as a TOI. If a taxpayer entered into a transaction after August 2, 2007, and it later becomes a listed or TOI transaction, the taxpayer must file a disclosure with OTSA within 90 days after the date the transaction became a listed transaction or TOI. If a taxpayer entered into a transaction before August 3, 2007, and it later becomes a listed or TOI transaction, the taxpayer must attach a Form 8886 to its next filed tax return after the date the transaction became a listed transaction or TOI. See Treasury Regulation § 1.6011-4(e)(2)(i) and Form 8886 instructions.

3.	What are the consequences for not filing a disclosure statement or for filing an incomplete disclosure statement?	If a taxpayer participated in a reportable transaction and filed an incomplete disclosure statement, or didn't file a disclosure statement with its return, and/or didn't file a complete disclosure statement with OTSA (if required), the IRS may assess a penalty under Internal Revenue Code (IRC) § 6707A. Where the taxpayer participated in a listed transaction, the period of assessment with respect to that transaction will remain open until the taxpayer or a material advisor properly discloses the participation in that transaction. See IRC § 6501(c)(10) for more information. In addition, where a reportable transaction is not properly disclosed, any IRC 6662A reportable transaction understatement penalty will apply at the 30% rate rather than the 20% rate for reportable transactions that are properly disclosed.
4.	What would be considered a complete disclosure?	A Form 8886 must be completed according to the instructions for the Form as well as the requirements of Treas. Reg. § 1.6011-4(d). The information provided on the Form must describe the expected tax treatment and all potential tax benefits expected from the transaction, describe any tax result protection with respect to the transaction, and identify and describe the transaction in sufficient detail for the IRS to be able to understand the tax structure of the reportable transaction and identify all parties involved in the transaction.
5.	Would a Form 8886 filed with no checked box on Line 7 (expected tax benefit criteria) and no description on Line 7b be considered complete?	No, the disclosure isn't complete because it didn't identify the tax benefits expected from the transaction or describe the transaction.

6.	Would the Form 8886 disclosure be considered complete if a taxpayer checked Box 2c for a transaction with contractual protection, but didn't describe the tax result protection with respect to the transaction in Line 7b of the form or in an attached statement to the form?	No, the disclosure isn't complete because it didn't describe the tax result protection with respect to the transaction
7.	Would a Form 8886 filed with a checked box on Line 5a, indicating participation through a related entity, but providing no related entity information on Lines 5b or 5c, be considered complete	If Line 5a has a checked box, Line 5b and/or 5c must be completed. The disclosure is incomplete.
8.	Is a statement that information will be provided upon request sufficient to be considered a complete disclosure?	A Form 8886 containing a statement that information will be provided upon request isn't a complete disclosure statement.
9.	Do these completeness requirements apply to protective disclosures as well?	Yes, filing a protective, but incomplete disclosure when a taxpayer has participated in a reportable transaction provides no protection from a potential IRC § 6707A penalty.

10.	A taxpayer files a Form 8886 disclosure indicating it entered into many transactions some of which may have been reportable transactions and some may not be reportable transactions under Rev. Proc. 2004-66 or other Angel List exclusions. Would this be considered a complete disclosure?	No, this wouldn't be a complete disclosure. A Form 8886 disclosure must be filed for each dissimilar reportable transaction in which the taxpayer participated. Each disclosure must contain specific information regarding the reportable transaction in which the taxpayer has participated.
11.	How does a taxpayer know if it has participated in a reportable transaction?	A taxpayer has participated in a reportable transaction if any of the criteria below are met: 1. Its tax return reflects tax consequences or a tax strategy described in the published guidance that identifies a transaction as a listed transaction. A list of such transactions is included in Notice 2009-59 (or successor guidance). 2. Its tax return reflects tax benefits from a transaction offered under conditions of confidentiality and it paid an advisor a fee of at least $250,000 if a corporation (or partnership or trust in which all owners or beneficiaries are corporations) or at least $50,000 for all other filers. Conditions of confidentiality exist where the advisor places a limitation on a taxpayer's disclosure of the tax treatment or tax structure of the transaction to protect the confidentiality of the advisor's tax strategies. 3. Its tax return reflects tax benefits from a transaction for which the taxpayer has a right to a full or partial refund of fees if all or part of the intended consequences from the transaction are not sustained, or the fees are contingent on the taxpayer's realization of tax benefits from the transaction. 4. The taxpayer's share of an IRC § 165 loss reported on its tax return from the transaction is: (a) if a C corporation or a partnership in which all partners are C corporations, at

		least $10 million in a single year or $20 million in any combination of taxable years; (b) if an individual or trust, at least $2 million in a single taxable year or $4 million in any combination of taxable years, or at least $50,000 in a single taxable year and the loss arose from an IRC § 988 (foreign currency) transaction; (c) if any other filer, at least $2 million in a single taxable year or $4 million in any combination of taxable years. 5. The taxpayer is within a class of persons identified as participants in a transaction of interest by published guidance that identifies a transaction as a transaction of interest. A list of such transactions is included in Notice 2009-55 (or successor guidance).
12.	What does the term “tax benefits” mean?	The term “tax benefits” includes any tax consequences that may reduce the taxpayer’s federal income tax liability by affecting the amount, timing, character, or source of any item of income, gain, expense, loss, or credit. Examples of tax benefits include (but are not limited to) deductions, exclusions from gross income, non-recognition of gain, tax credits, adjustments (or the lack of adjustments) to the basis of property, and status as an entity exempt from federal income tax.

13.	A partnership has two partners, a corporation and an individual, with 80% of the partnership's losses allocated to the corporate partner. In the current year, the partnership entered into a transaction and incurred an IRC § 165 loss of $12 million which it reported on its tax return. The partnership must disclose this transaction because the IRC §165 loss of $12 million is greater than $2 million. Do the partners also need to disclose this transaction?	The corporate partner's distributive share of the partnership's $12 million IRC § 165 loss is $9.6 million. The corporation doesn't have a disclosure requirement as its share of the § 165 loss is less than the $10 million corporation threshold. The individual partner will have to disclose its $2.4 million share of the loss since it's over the $2 million individual threshold.
14.	Does an individual with an IRC § 165 loss in the current year that arose from a single IRC § 988 transaction of $50,000 have a Form 8886 disclosure requirement?	Yes, an individual or a trust with an IRC §165 loss that arose from a single IRC § 988 transaction of $50,000 or more in a single taxable year has a disclosure requirement.

15.	An individual partner has a distributive share of partnership losses of 5%. In the current year, the partnership entered into one IRC § 988 transaction and incurred an IRC § 165 loss of $1.5 million. The partnership doesn't have a disclosure requirement because the IRC § 165 loss of $1.5 million isn't more than $2 million. Does the individual partner need to disclose this transaction?	Yes, because the individual partner's allocable share of the partnership's $1.5 million IRC §165 loss that arose from an IRC § 988 transaction is $75,000, which is greater than the $50,000 IRC §988 loss threshold for an individual or trust.

Page Last Reviewed or Updated: 22-Aug-2018

Report No. 1400

NEW YORK STATE BAR ASSOCIATION TAX SECTION

REPORT ON PROPOSED FOREIGN CURRENCY HEDGING REGULATIONS

September 5, 2018

TABLE OF CONTENTS

Page

TABLE OF CONTENTS
(continued)

Page

I. INTRODUCTION

This Report[1] (the "**Report**") addresses the request for comments included in REG11914-15 regarding proposed regulations under sections 446, 954 and 988,[2] which the Department of Treasury ("**Treasury**") and the Internal Revenue Service ("**IRS**") issued on December 19, 2017 (collectively, the "**Proposed Regulations**").[3] More particularly, this Report addresses issues raised by the Proposed Regulations that involve the application of the foreign personal holding company income ("**FPHCI**") rules with respect to transactions that hedge foreign currency risk. We applaud Treasury and the IRS for addressing long-standing asymmetries arising from a controlled foreign corporation's ("**CFC**") foreign currency hedging activities.

The preamble to the Proposed Regulations (the **"Preamble"**) identified several aspects of the existing regulatory framework that result in mismatches between the classification (as subpart F income or not subpart F income) and/or the "timing" of related items of foreign currency gain or loss incurred by a CFC, and proposed sensible adjustments to the rules. These adjustments, will help ensure that, to the extent that the statutory framework permits, a U.S. shareholder's economically realized section 988 gain/loss is appropriately reflected in the U.S. shareholder's subpart F inclusion.

The Proposed Regulations were especially timely in that they were released in the same week that the P.L. 115-97 (the "**Act**") was enacted. The new current inclusion regime for non-subpart F income of CFCs increases the need to appropriately measure the subpart F income arising from section 988 transactions. Further, given the rate differential for subpart F inclusions, section 951A inclusions, and dividends eligible for a section 245A deduction, the proper delineation impacts rates, whereas in the pre-Act law it only implicated timing. We also address certain issues relating to the Proposed Regulations that arise under the Act.

In addition, the Proposed Regulations helpfully address the treatment of a CFC's foreign currency hedge of a net investment when it conducts business operations in a currency environment that differs from the CFC's functional currency. In this Report, we offer several comments and suggestions with respect to this complex topic.

Finally, the Preamble describes dates of applicability for the various provisions. These dates of applicability are significant for several reasons, including that some of the sensible new provisions could be viewed as adjustments or clarifications of the rules to conform them to existing taxpayer positions. We believe that Treasury and the IRS should clarify how they intend to treat pre-effective date transactions.

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[1] This Report was written by Peter J. Connors and Isaac MacDonald with the substantial assistance of Joshua Emmett. Significant contributions were made by Jeffrey Maddrey, John McDonald and Jo Lynn Ricks and helpful comments were provided by Robert Cassanos, Robert H. Dilworth, John Lutz, Michael Farber, Lucy Farr, Peter Fucci, Erika Nijenhuis, Carolina Perez, Michael Schler, Karen Gilbreath Sowell, Shun Tosaka and Howard Weiner.

[2] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1986, as amended (the "**Code**") and the Treasury Regulations promulgated thereunder.

[3] Fed. Reg. 60135 (12/19/ 2017).

Part II of this Report provides background regarding the treatment of foreign currency under subpart F. Part III summarizes our recommendations. Part IV contains a detailed analysis of the issues and our recommendations.

II. **BACKGROUND**

A. Treatment of Foreign Currency Under Subpart F

Under the Code, foreign currency gain is a separate category of FPHCI.[4] FPHCI is generally considered passive income for foreign tax credit purposes.[5] In general, these rules provide that this category of FPHCI include only the excess of foreign currency gains over foreign currency losses attributable to a section 988 transaction. Further, losses in foreign currency only offset foreign currency gain and will not generally offset other categories of foreign base company income.[6] Moreover, losses may only offset gains in the year in which they arise – there is no ability to "carry forward" currency losses to a future year as there is in the domestic context under section 172.[7] Specifically, where there is section 988 gain (and therefore subpart F income) in one year and an economically related section 988 loss in a different year, the CFC's lifetime FPHCI is overstated. This puts a premium on ensuring that offsetting currency gains and losses are recognized in the same tax year, a subject this Report addresses further below.

Section 954(c)(1)(D) excludes from FPHCI any foreign currency gain or loss attributable to a transaction directly related to the business needs of the CFC. To qualify for the business needs exclusion, foreign currency gain or loss must, in addition to satisfying other requirements, arise from a transaction entered into, or property used, in the normal course of the CFC's business that does not itself (and could not reasonably be expected to) give rise to subpart F income (other than foreign currency gain or loss). One of the relevant requirements is that the foreign currency gain or loss needs to be clearly determinable from the records of the CFC as being derived from such transaction or property. Foreign currency gain or loss attributable to certain "bona fide hedging transactions" with respect to a transaction or property that qualifies for the business needs exclusion also qualifies for the business needs exclusion.[8] The regulations also provide a framework under which aggregate hedges can qualify as bona fide hedges.

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[4] *See* section 954(c)(1)(D).

[5] Treas. Reg. § 1.904-4(b)(2)(A).

[6] § 954(c)(1)(D); Treas. Reg. § 1.954-2(g)(2)(i). Treas. Reg. §1.954-2(g)(4) provides an election, however, that causes currency gain or loss to be added to (or subtracted from) net FPHCI.

[7] It is possible for a loss to reduce subpart F income via the "current year earnings and profits" limitation in section 952. Nevertheless, if that route is followed, a section 952(c) recapture account is created and non-subpart F income that is subsequently recognized is recast as subpart F income.

[8] Treas. Reg. § 1.954-2(a)(4)(ii). To be a bona fide hedging transaction, the transaction must meet the requirements of Treasury regulations section 1.1221-2((a) through (d), except that in applying section 1.1221-2(b)(1), the risk being hedged may be with respect to ordinary property, section 1231 property or a section 988 transaction. The taxpayer must meet the identification and recordkeeping requirements of Treasury regulations section 1.1221-2(f).

The section 954 rules provide an election to treat all foreign currency gain or loss as FPHCI.[9] They also provide an election that allows taxpayers to characterize foreign currency gain or loss in the same specific category of subpart F income as gain or loss in that category.[10] In some circumstances these elections can mitigate basketing issues. However, these elections are only helpful in some cases, and the current regulations create certain problems when taxpayers attempt to make these elections in practice. We discuss these issues below.

1. In Practice, Currency Hedges Are Often Hedges of Aggregate Risks

As discussed below, most hedging activity is done on an "aggregate hedging basis" under which the taxpayer aggregates risk under several transactions that have occurred or are expected to occur and enters into a hedging contract to offset the risk. [11]

As described in the Preamble, under the section 954 rules, the underlying transaction in a hedging transaction cannot reasonably be expected to give rise to subpart F income (often described as creating a "cliff effect"). That is, if even a de minimis amount of income or gain from the underlying transaction or property is subpart F income, other than foreign currency gain or loss, the entire foreign currency gain or loss from the hedging transaction is included in the FPHCI computation.

These rules are significant because most hedging activity is done on an "aggregate hedging basis" under which the taxpayer aggregates risk under several transactions and enters into a hedging contract to offset the risk. When this occurs, the individual items being hedged could generate subpart F income or non-subpart F income.[12] Thus, the section 954 rules create a whipsaw effect whereby the losses on the underlying transactions do not reduce FPHCI, but the gains on the hedging transactions generate FPHCI. Further, when the hedges produce losses, the losses are not always fully utilizable (*i.e.*, they cannot be carried backward or forward to offset the CFC's hedge gains in a prior or subsequent year).[13]

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[9] Treas. Reg. § 1.954-2(g)(4).

[10] Treas. Reg. § 1.954-2(g)(3).

[11] Treasury regulations section 1.1221-2(c)(3) states that the term "hedging transaction" includes a transaction that manages an aggregate risk of interest rate changes, price changes, and currency fluctuations only if all of the risk, or all but a de minimis amount of the risk, is with respect to ordinary property, ordinary obligations, or borrowings. Treasury regulations section 1.954-2(g)(2)(ii)(B)(2) in turn generally provides that for purposes of the business needs exclusion, a hedging transaction will satisfy the aggregate hedging rules of section 1.1221-2(c)(3) only if all (or all but a de minimis amount) of the aggregate risk being hedged arises in connection with transactions or property that qualifies for the business needs exclusion, and any gain or loss arising from such transactions or property that is attributable to changes in exchange rates is clearly determinable from the records of the CFC as being derived from such transactions or property.

[12] Treasury regulations section 1.1221-2(d)(3) states that the term "hedging transaction" includes a transaction that manages an aggregate risk of interest rate changes, price changes, and currency fluctuations only if all of the risk, or all but a de minimis amount of the risk, is with respect to ordinary property, ordinary obligations, or borrowings.

[13] One potential approach to minimizing the whipsaw for treasury center operations would be to use a foreign entity treated a partnership whose partners are members of a domestic affiliated group that files a consolidated return. Prior to issuance of Treasury regulations section 1.956-4 in 2007, such an entity could realize and recognize currency gain and losses without regard to the inclusion asymmetries arising under section 954(c)(1)(D).

2. The Current Rules May Create Unnecessary Risks for Treasury Centers

In 2013, the Tax Section addressed certain issues relating to a transaction in which a CFC served as a treasury center making loans and borrowing money from affiliates.[14] The activities of a treasury center with related parties are typically not eligible for the exception under subpart F for "regular dealer activities."[15] They are also not eligible for the active financing exception under subpart F.[16] Nevertheless, most treasury centers are considered "dealers" and are required to mark their securities to market under section 475. Normally, this would allow all currency gains and losses to be marked-to-market annually and therefore offset each other from a timing standpoint. In a situation where the long and short positions with respect to the same currency are balanced, the treasury center would have no net gain or loss. However, under the section 475 regulations, liabilities generally are not eligible to be marked-to-market and, therefore, it is not clear whether currency-denominated liabilities (or the foreign currency element of such liabilities) can be marked-to-market.[17] As a result, the treasury center could recognize FPHCI even though its long and short positions in each currency economically offset each other. The 2013 Report proposed a number of solutions to address this concern that could be implemented through regulations. In practice, many taxpayers have treated foreign currency liabilities as short positions in the currency, allowing for mark-to-market treatment.

3. The Current Regulations Have a Special Rule for Interest-Bearing Liabilities

Another provision of concern to taxpayers is the rule under the current regulations that allocates foreign currency gain or loss on interest-bearing liabilities between subpart F and non-subpart F based on the rules for allocating interest expense. There is no corresponding rule for gain or loss generated by transactions that are bona fide hedges with respect to interest bearing liabilities. This is another situation that has the potential for a whipsaw effect.

B. The Current Rules Do Not Adequately Address Hedges of CFCs or of QBUs, Including the Related Section 987 Issues

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[14] *See* New York State Bar Association Tax Section Report No. 1287, *Report on Subpart F Issues Involving Currency Gain and Loss* (June 3, 2013) (the "**2013 Report**"), pages 7-34 (discussing treasury center loan issues).

[15] § 954(c)(2)(C); Treas. Reg. §1.954-2(a)(4)(iv) (defining "regular dealer"), Treas. Reg. §1.954(a)(4)(v) ("dealer property"), Treas. Reg. §1.954-2(a)(4)(ii) ("bona fide hedging transaction").

[16] § 954(h).

[17] Although Treasury regulations section 1.475(c)-2(a)(2) generally excludes from the definition of a security a debt instrument issued by the taxpayer, it does not address borrowings in a nonfunctional currency, and the statute, in section 475(c)(2)(E) expressly includes within the definition of a security, a "short position … in … currency," which is included in a foreign currency borrowing (like a short seller of foreign currency, a borrower of foreign currency incurs a loss upon repayment when the currency increases in value). *See also* section 1092(d)(7) (treating an obligor's interest in a nonfunctional currency debt obligation as a position in the nonfunctional currency). In 2016, Treasury and the IRS included guidance under section 988 in its business plan, thereby acknowledging the possibility of additional regulations that could clarify further the application of the mark-to-market method to foreign currency borrowings. *See* https://www.irs.gov/pub/irs-utl/2016-2017_pgp_initial.pdf at 17.

The 2013 Report also addressed the treatment of hedges of disregarded loans made by CFCs to their qualified business units ("**QBUs**"), a common transaction, but it made no recommendation. Such a hedge is generally entered into for Generally Accepted Accounting Principles ("**GAAP**") or International Financial Reporting Standards ("**IFRS**") reasons, and does not exist for U.S. tax purposes. Yet, it also creates a potential whipsaw effect. Specifically, the CFC recognizes hedge gain as subpart F income without any offsetting loss on the underlying transaction. Yet hedged currency losses are not tax-effected.[18]

Foreign currency hedging activities also raise issues under section 987 of the Code. Section 987 requires the recognition of the branch translation gain or loss of a QBU upon certain remittances. Timing and characterization issues arise with respect to gain or loss realized on hedges of assets, liabilities, and income and expense flows that arise from the QBU. These are important issues given that many taxpayers operate through foreign holding companies which, in turn, have operating subsidiaries that have elected to be disregarded entities for U.S. tax purposes. For financial reporting purposes, these operating subsidiaries will use local currencies that may differ from that of the foreign holding company. For example, a U.K. holding company that uses pounds sterling as its functional currency may have subsidiaries in Europe that have elected to be treated as disregarded entities and that use the euro or the Swiss franc as their functional currency. Two sets of regulations potentially govern section 987 transactions: (1) those proposed in 1991 (the "**1991 Proposed Regulations**") and (2) the much more comprehensive, yet controversial, regulations finalized in 2016 (the "**Final 987 Regulations**"). One of the more controversial aspects of these regulations is that they treat some section 987 gain as subpart F income to the extent apportioned to assets that generate subpart F income.[19]

Under the 1991 Proposed Regulations,[20] the income or loss of a section 987 QBU for the year is calculated in the QBU's functional currency, and that amount is translated into its

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[18] Net investment hedges of a "regarded" CFC would not qualify for hedge treatment given that the asset being hedged is a capital asset. An earlier Tax Section report issued in 1990 had addressed the treatment of net investment hedges made by a U.S. parent of its CFC and recommended that an adjustment to the amount of income realized by the taxpayer in respect of actual or deemed distributions from the foreign subsidiary be permitted. New York State Bar Association Tax Section Report No. 656, *Report on Section 988 Temporary Regulations* (May 7, 1990), page 83 (discussing section 988 temporary regulations).

[19] *See* Treas. Reg. § 1.987-6(b). We note that the Tax Section report on the 2006 proposed regulations concluded that there was statutory authority for such treatment. *See* New York State Bar Association Tax Section Report No. 1140, *Report on Proposed Regulations under Section 987* (January 3, 2008), page 70. On June 13, 2018, Treasury and the IRS announced (Notice 2018-57, 2017-42 I.R.B. 324) that they intend to amend the final regulations under section 987, as well as certain related provisions of the temporary regulations under that section, to delay the applicability date of those regulations by one additional year. Treasury and the IRS had previously delayed the application of the Section 987 regulations by one year in Notice 2017-57 — after the regulations were identified in Notice 2017-38 (along with seven other regulations) as significant tax regulations requiring additional review under Executive Order 13789.

[20] A detailed discussion of these regulations, as well as alternative methods patterned on the 1991 Proposed Regulations (including the so called "earnings only method" under which section 987 gain or loss is recognized with respect to earnings but not capital invested in the QBU) is provided in New York State Bar Association Tax Section Report No. 1386, *Report on Notice 2017-57: Alternative Rules for Determining Section 987 Gain or Loss* (January, 2018) pages 7-14 Consistent with the recommendations of that report, where section 987 is relevant, this Report takes an approach to section 987 that is patterned on the 1991 Proposed Regulations. We have noted below instances where we believe that the specific section 987 regime that is applied may impact the analysis in this Report.

owner's functional currency based on the average exchange rate for the year. The owner of the QBU then recognizes section 987 gain or loss upon a remittance from the QBU (or its termination) under an equity pool method. Under this method, an owner of a section 987 QBU is required to maintain a "basis pool" in the owner's functional currency, and a separate "equity pool" in the QBU's functional currency. When an asset is transferred to the section 987 QBU, the basis pool is increased by the adjusted basis of the transferred asset. This amount is then translated into the section 987 QBU's functional currency, based on the spot rate on the date of transfer, and then added to the equity pool of the section 987 QBU. Earnings of the section 987 QBU are added to the basis pool (in the owner's functional currency) and the equity pool (in the section 987 QBU's functional currency). At any given time, the unrealized section 987 gain or loss with respect to the section 987 QBU is equal to the difference between (i) the equity pool translated into the owner's functional currency at the current spot rate and (ii) the basis pool. Upon a remittance from the section 987 QBU to its owner, the amount of section 987 gain or loss realized and recognized is equal to the product of (i) the unrealized section 987 gain or loss at the time of the remittance and (ii) the portion of the section 987 QBU's balance sheet (measured by adjusted basis in the section 987 QBU's functional currency) remitted.

Regulations proposed under section 987 in 2006 described an "earnings only" variation of the 1991 Proposed Regulations as a "reasonable method" of complying with section 987.[21] Under an "earnings only" method, the general equity pool method described in the 1991 Proposed Regulations is followed, except that the basis and equity pools are only increased as a result of earnings of the section 987 QBU. Remittances would be allocated between earnings and capital (either first to earnings until all earnings are remitted or pro-rata between earnings and capital). Importantly, under an "earnings only" method, a change in the value of contributed assets that arises because of a fluctuation in exchange rates is not reflected in section 987 gain or loss (including upon a remittance or termination of the section 987 QBU).

The basic operation of the 1991 Proposed Regulations and the "earnings only" method can be illustrated by the following example. Suppose that a CFC whose functional currency is the U.S. dollar wholly owns a section 987 QBU whose functional currency is the euro ("**Euro QBU**"). At the beginning of year 1, the CFC transfers $100 to the Euro QBU at a time when the exchange rate is $1 to €1. During year 1, Euro QBU has income of €20. The average exchange rate for year 1 is $1 to €1.25. At the beginning of year 2, Euro QBU remits €40 to the CFC at a time when the exchange rate is $1 to €1.5.

Under the 1991 Proposed Regulations, immediately before the CFC remits €40, the CFC has a basis pool of $116 (*i.e.,* $100 + €20 x $1/€1.25) and an equity pool of €120. Accordingly, at that time, Euro QBU has unrealized section 987 loss equal to -$36 (*i.e.,* €120 x $1/€1.5 - $116). The remittance at the beginning of year 2 triggers recognition of section 987 loss equal to -$12 (*i.e.,* -$36 x €40/€120).

Under an "earnings only" method that treats remittances as being sourced first to earnings, immediately before the CFC remits €40, the CFC has a basis pool of $16 (*i.e.,* €20 x

[21] 71 Fed. Reg. 52876 (Sept. 7, 2006), corrected, 71 Fed. Reg. 77654 (Dec. 27, 2006). *See also* Notice 2000-20, 2000-1 C.B. 851 (Mar. 22, 2000) (requesting comments on the potential adoption by Treasury and the IRS of an approach under which section 987 gain or loss is computed only on remittances of earnings of the applicable QBU).

$1/€1.25) and an equity pool of €20. Accordingly, at that time, Euro QBU has unrealized section 987 loss equal to -$2.67 (*i.e.*, €20 x $1/€1.5 - $16). The remittance at the beginning of year 2 triggers recognition of the entirety of the -$2.67 section 987 loss.

Illustration of 1991 Regulations Versus Earnings Only Approach

	1991 Regulations	*Earnings Only*
Beginning of Year 1:		
Contribution by CFC	$100.00	$100.00
Net Income	€20.00	€20.00
Prior to remitting €40 in Year 2:		
Basis Pool	$116.00	$16.00
Equity Pool	€120.00	€20.00
Upon Remittance of €40 in Year 2:		
Unrealized Section 987 Gain (Loss)	($36.00)	($2.67)
Section 987 Gain (Loss) Triggered on Remittance of €40	($12.00)	($2.67)
Beginning Year 1 Exchange Rate	$1 to €1	
Average Year 1 Exchange Rate	$1 to €1.25	
Beginning Year 2 Exchange Rate	$1 to €1.5	

C. Importance of Financial Accounting

Because foreign currency hedging is often driven by financial accounting considerations more than by tax objectives, the development of tax rules for hedging activities needs to be considered in the context of the financial accounting standards.[22] While foreign currency exposure is generally remeasured in preparing a company's income statement, foreign currency exposure related to foreign subsidiaries is not reflected in a company's income statement. Instead, it is reflected in the balance sheet. The balance sheet reflects increases or decreases in the value of (measured in U.S. dollars) equity investments in businesses conducted in non-U.S.-dollar currency environments. These increases or decreases are reflected in the cumulative translation adjustment ("**CTA**") account associated with the investment and are recorded in the U.S. parent's other comprehensive income ("**OCI"**) account. Revenues, expenses, gains, and losses appear in OCI when they have not yet been realized. The OCI account is an equity account and does not impact financial statement income until a realization event occurs. Under GAAP, a realization event occurs only when there is a liquidation of the foreign subsidiary. Given that income statement changes impact earnings per share and changes to the OCI account do not, companies tend to be more concerned about transactional currency gains or losses that are reflected on the income statement and have the potential to create income statement volatility. Nevertheless, some companies that are regulated by or subject to stringent debt covenants may also be concerned about balance-sheet volatility. Whether for income statement

[22] The IRS, in practice, has often deferred to financial accounting. *See, e.g.*, PLR201816009 (hedge treatment permitted, under Treasury regulations section 1.988-5(e), where taxpayer complied with accounting requirements of ACS 815 in connection with hedges of subsidiary's foreign currency exposure with respect to its anticipated foreign currency-denominated media production costs).

purposes or balance-sheet purposes, companies often seek to hedge these currency exposures if they are material. If the hedge gains and losses are reflected on the taxpayer's return but the underlying currency gains and losses are not reflected on the taxpayer's income statement, it creates a problematic disconnect.

D. The Impact of the Act

The Act has changed some of the consequences that result from the determination of whether an item of income is subpart F income or non-subpart F income. The Act included both a significant corporate rate reduction (from 35% to 21%) and the enactment of the Global Intangible Low Taxed Income ("**GILTI**") regime, which generally taxes income at a 10.5% tax rate but significantly reduces the benefits of foreign tax credits associated with such income.[23] Another potentially relevant provision is the new section 267A, which disallows deductions for interest and royalties paid or accrued to a related party pursuant to a "hybrid transaction" or by, or to, a "hybrid entity."

New policy considerations seem to arise under the Act. In this regard, it seems possible to infer that Congress intended that (1) there be no deferral for investment activities and for those activities to be taxed at normal corporate rates and (2) business activities be taxed at a favorable rate.

E. Categorizing Hedging Transactions

In analyzing the different categories of subpart F income that arise from foreign currency hedging transactions, it is useful to consider that seven classes of foreign currency gain or loss seem to emerge:

Category 1 (investments and related hedges). This category includes section 988 gain or loss arising from foreign currency-denominated debt, currency, and foreign currency derivatives that function as hedges where the assets are in the nature of investment assets, not trade or business assets.

Category 2 (foreign currency assets and hedges core to a trade or business). This category includes section 988 gain or loss arising in a trade or business (such as receivables and working capital) and derivatives that hedge this capital.

Category 3 (treasury centers). This includes the section 988 gain or loss of a CFC that aggregates and manages group-wide foreign currency and cash.

Category 4 (hedges of net investment in QBU). This category includes section 988 gain or loss from derivatives that hedge the net investment (both in the form of equity or debt) of an activity that is considered a section 987 QBU of the CFC.

[23] § 951A. *See* New York State Bar Association Tax Section Report No. 1394, *Report on the GILTI Provisions of the Code* (May 4, 2018).

Category 5 (hedges of net equity investment in CFC). This category includes section 988 gain or loss from derivatives that function as hedges of a CFC's net investment of an equity investment in a CFC.

Category 6 (hedges of debt investment in CFC). This category includes section 988 gain or loss from derivatives that function as hedges of a CFC's investment in foreign currency-denominated debt of a CFC (other than debt of a CFC Treasury center, described in category no. 1 or 2 above).

Category 7 (natural hedges). This category includes section 988 gain or loss from debt and derivatives that function as hedges of the debt.

While Category 1 transactions, which relate to investments and hedging activity, should continue to be treated as FPHCI as there is no policy rationale to justify either tax deferral or a lower rate, the remaining six categories merit symmetrical (favorable) treatment, at least in part, under the present-day subpart F rules. The only exception to the foregoing would be with respect to a hedge of debt investment in a CFC that functions as a treasury center, which may not qualify for deferral under the existing FPHCI rules.

F. The Proposed Regulations

The Proposed Regulations address the core subpart F classification and timing issues in several ways. First, it addresses the classification issue by expanding the business needs exclusion so that the exception can serve its intended purpose—excluding from FPHCI those items of foreign currency gain or loss that arise from business activities, and not investment activities, of the CFC. Second, it addresses the timing mismatch issue in two ways: (i) it expands the scope of the existing hedge timing rules to clearly cover all bona fide hedging transactions and (ii) it provides an elective mark-to-market regime for items of section 988 gain or loss. The Proposed Regulations also take an important step forward in resolving issues relating to net investment hedges and moving tax treatment of hedges closer to their corresponding GAAP treatment by introducing the concept of a "financial statement hedging transaction."

First, under the Proposed Regulations, the exception for bona fide hedging transactions was modified so that it applies to property that gives rise to both subpart F income (other than foreign currency gain or loss) and non-subpart F income. Under revisions to Treasury regulations section 1.954-2(g), foreign currency gain or loss attributable to a transaction or any property that gives rise to both subpart F income (other than foreign currency gain or loss) and non-subpart F income, or a bona fide hedging transaction with respect to such a transaction or property, and that otherwise satisfies the requirements of the business needs exclusion, is allocated between subpart F income and non-subpart F income in the same proportion as the income from the underlying transaction or property.[24] Second, the rule that allocates foreign currency gain or loss arising from interest-bearing liabilities was modified so that it also applies to foreign currency gain or loss arising from bona fide hedging transactions with respect to such liabilities.[25] Third, the definition of a bona fide hedging transaction was expanded to include the

[24] Prop. Treas. Reg. §1.954-2(g)(2)(ii)(C)(1).

[25] Prop. Treas. Reg. §1.954-2(g)(2)(iii).

acquisition of a debt instrument that has the effect of managing risk with respect to an interest-bearing liability.[26] Fourth, the Proposed Regulations added rules for "financial statement hedging transactions." These are generally hedges by a CFC of its net investment in a QBU. Proposed Treasury regulations section 1.954-2(g)(2)(ii)(C)(2) provides that the qualifying portion of any foreign currency gain or loss that arises from a financial statement hedging transaction with respect to a QBU and that is allocable to non-subpart F income is directly related to the business needs of a CFC.

Changes were also made to both the section 988 and 446 regulations. A new section, proposed Treasury regulations section 1.988-7, was added. It permits taxpayers to elect to use a mark-to-market method of accounting with respect to section 988 transactions, which include becoming an obligor under an interest-bearing liability. Unlike the operation of section 475 or section 1256, the elective mark-to-market treatment considers only changes in the value of the section 988 transaction attributable to exchange rate fluctuations and does not take into account changes in value due to other factors, such as change in market interest or the creditworthiness of the borrower. As discussed below, this is more consistent with the U.S. GAAP accounting rules, which require that non-functional currency assets and liabilities be "remeasured" rather than marked-to-market.

As explained in the Preamble, the Proposed Regulations require appropriate adjustments be made to prevent section 988 gain or loss from being considered again under section 988 or another provision of the Code. The mark is not limited in the case of a debt instrument by the economic gain or loss on the instrument, as provided in Treasury regulations section 1.988-2(b)(8). This election is made by filing a statement with the taxpayer's timely-filed original federal income tax return for the taxable year for which the election is made. Once made, the election may be revoked at any time. However, once the election has been revoked, it may not be made again for six years and then may not be revoked until six years after the subsequent election is made. The addition of the mark-to-market rule specifically addresses the issue that treasury centers had with respect to liabilities. This rule is similar to a provision that was proposed in 1992 and never finalized.[27]

Changes were also made to Treasury regulations section 1.446-4. This section requires gain or loss from a hedging transaction to be taken into account at the same time as the gain or loss from the item being hedged. Under current law, this provision only applies to hedging transactions defined in Treasury regulations section 1.1221-2(b). However, bona fide hedging transactions under section 954 include hedging transactions defined in both Treasury regulations section 1.1221-2(b) and transactions involving section 1231 property and section 988 transactions. Proposed Treasury regulations section 1.446-4 addresses this by providing that bona fide hedging transactions are subject to the hedge timing rules of Treasury regulations section 1.446-4. We note that the expansion of the timing rules to include bona fide hedging transactions did not change the requirement for exemption from the applicable straddle rules that

[26] Prop. Treas. Reg. §1.954-2(a)(4)(ii)(A). The acquisition of a debt instrument generally is not a hedging transaction for purposes of section 1221. *See* Treas. Reg. §1.1221-2(d)(5)(i).

[27] (INTL-0015-91) Prop. Treas. Reg. §1.988-5(f) [March 17, 1992].

the hedged items be ordinary property, ordinary obligations, or borrowings, as discussed further below.

To facilitate a transition into the rules, taxpayers who have made prior elections to eliminate the basketing issues associated with foreign currency gain or loss (*i.e.*, under Treasury regulations sections 1.954-2(g)(3) and (g)(4)) are allowed to revoke these elections without the need to obtain consent.[28]

Taxpayers may rely on the proposed amendments, other than those relating to bona fide hedging transactions, for taxable years ending on or after December 19, 2017, provided the taxpayer consistently applies the proposed amendment for all such taxable years that end before the first taxable year ending on or after the Proposed Regulations are published as final regulations. Taxpayers may rely on the proposed amendments to proposed Treasury regulations sections 1.446-4(a), 1.954-2(a)(4)(ii)(A), 1.954-2(g)(2)(ii)(C)(1) and 1.954-2(g)(2)(iii) with respect to bona fide hedging transactions entered into on or after December 19, 2017, provided the taxpayer consistently applies the proposed amendment to all bona fide hedging transactions entered into on or after such date and prior to the date that the regulations are published as final regulations.

G. The Request for Comments

The Preamble requests comments on three topics. These include: (1) the timing rules of Treasury regulations section 1.446-4; (2) the potential application of the business needs exclusion to a hedge of a CFC's investment in another CFC; and (3) the potential application of the business needs exclusion to transactions that hedge a disregarded transaction between a CFC and its QBU. Below, we address these issues and other issues we have identified while working with the Proposed Regulations.

III. **SUMMARY OF RECOMMENDATIONS**

In response to the request for comments in the Preamble, we make several recommendations. These recommendations are discussed in more detail in Section IV but include the following:

A. Application of the Business Needs Exclusion to Aggregate Hedges

The Proposed Regulations refer to bona fide hedges of a transaction (not transactions) and property (not properties) giving rise to both subpart F and non-subpart F income. This could arguably exclude aggregate hedges of such property (or aggregate hedges of net exposure from assets and liabilities) from the definition of "bona fide hedges" under section 954. We believe that it was an oversight that the Proposed Regulations did not (at least explicitly) address issues relating to aggregate hedges, and recommend that the final regulations address aggregate hedges. In particular, we recommend that taxpayers be able to treat a ratable share of their aggregate

[28] We note that because subpart F income is exempt from the GILTI regime, it is possible that some taxpayers will continue to make the same category election under Treasury regulations section 1.954-2(g)(3) even in light of the adoption of the revised business needs exclusion.

hedges as bona fide hedges if some (but not all) of the underlying transactions generate subpart F income (other than foreign currency gains).

B. Issues Under Proposed Treasury Regulations Section 1.988-7

There is a question as to who can make the election under proposed Treasury regulations section 1.988-7 and whether making the election for one trade or business will affect the ability of another trade or business to choose whether or not to make the election. We recommend Treasury and the IRS consider allowing flexibility in making this election, subject to appropriate constraints to limit the opportunity for "cherry picking." We also recommend clarification of the requirement that appropriate adjustments be made to prevent duplication of section 988 gain or loss from being taken into account again under another provision of the Code or regulations and set forth one approach for doing so. One approach we discuss would involve delaying the adjustment to basis until the asset is disposed of. In addition, we believe that the straddle rules should not apply where offsetting positions in foreign currency are both required to be marked-to-market under proposed Treasury regulations section 1.988-7. Finally, we recommend that Treasury and the IRS confirm that an election under proposed Treasury regulations section 1.988-7 does not require the consent of the IRS or, alternatively, is a change in method of accounting for which the consent is automatically granted, and confirm whether an adjustment under section 481(a) is required.

C. Clarification of the Allocation Rule in the Business Needs Exclusion

Where foreign currency gain or loss arising from a transaction or property gives rise to both subpart F income (other than foreign currency gain or loss) and non-subpart F income, or a bona fide hedging transaction with respect to such a transaction or property, and that otherwise satisfies the requirements of the business needs exclusion, there is a question about how to compute the amount of foreign currency gain or loss that is allocated to non-subpart F income. We recommend that Treasury and the IRS clarify how this allocation should be computed.

D. Incorporation of Risk Management Standard for Purposes of the Business Needs Exclusion

We recommend that Treasury and the IRS confirm that the risk management standard, as opposed to the risk reduction standard, be used in applying the business needs exclusion. Because of the complexity that already exists in QBU-related transactions, it seems appropriate to use the more flexible risk management standard. We believe that such a change would be in the nature of a technical correction.

E. Effective Date Issues

One reading of the Preamble would permit taxpayers to rely on and apply proposed Treasury regulations section 1.988-7 for purposes of tax years ending after December 17, 2017. However, the Preamble could also be read to suggest that proposed Treasury regulations section 1.988-7 cannot be relied on by taxpayers prior to the issuance of final regulations. The question arises as to what taxpayers should do if the Proposed Regulations are not finalized by the date their tax return is due. There have been conflicting public statements by government officials on

this issue. The final regulations or some other guidance should address the issue regarding the applicability date in the Preamble to the Proposed Regulations.

F. Timing of Recognition of Hedging Gains and Losses on Net Investment Hedges in a QBU

Net investment hedges may be entered into with respect to the net assets invested in a QBU or with respect to an equity investment in a CFC. These two situations are addressed separately. The former situation is discussed in the following paragraph. We address the latter situation in the following section.

We recommend several approaches for determining when gain or loss could be recognized on net investment hedges in a QBU. One possibility is that the recognition be matched to the timing of recognition of section 987 gain or loss with respect to the QBU. A second is to defer recognition of items until the termination of the QBU. A third is to defer recognition of items on the QBU Hedge ("**QBU Hedge**") until such items are recognized GAAP purposes. A fourth approach is just to allow ordinary timing rules to control. We recommend the first approach (matching the hedging gain or loss with the section 987 gain or loss on the QBU).

G. Application of the Business Needs Exclusion to Net Investment Hedges

We believe that the business needs exclusion should be broadened to include hedges of a CFC's net investment in a regarded corporate subsidiary ("**CFC Hedge**"). This would be consistent with the legislative history of the business needs exclusion. With respect to the question of how gain or loss with respect to a CFC Hedge should be allocated between subpart F and non-subpart F income, there are multiple approaches. Our principal recommendation is to permit taxpayers to elect to capitalize such gain or loss into the basis of the applicable corporate subsidiary, which would in effect cause the subpart F treatment of such gain or loss to be matched to the subpart F treatment of any gain or loss realized on a disposition of the stock of the subsidiary. If the gain or loss on the CFC Hedge is not capitalized, an assets test (based on fair market value or tax basis) or an income test could be used. We recommend giving taxpayers the option of choosing which test to use. With respect to the timing of the gain or loss, mirroring the timing rules for QBU Hedges with respect to the investment in the CFC may not be appropriate. If taxpayers are permitted to capitalize gain or loss on a CFC Hedge, as we recommend, capitalization will in effect cause the recognition of gain or loss on the CFC Hedge to be matched to recognition of the gain or loss recognized upon a taxable disposition of the stock. As an alternative, we discuss a few possibilities, each with its own advantages and disadvantages. We also believe that hedges of investments in indirect subsidiaries should be eligible for the business needs exclusion.

H. Application of the Business Needs Exclusion to Disregarded Transactions

We believe the business needs exclusion should apply to hedges of disregarded transactions (*e.g.*, disregarded loans) ("**Loan Hedges**"). We also believe it may be helpful to establish a default rule where, in the absence of an affirmative identification of underlying assets, the QBU is treated as hedging a pro rata share of the assets of the applicable QBU. With respect to timing, we suggest, where it is possible, to associate the hedge with particular assets to match

recognition on the hedge to those particular assets. Alternatively, the timing of recognition of the Loan Hedge can be matched with the associated remittance.

I. Expansion of the Hedging Rules

To clarify that the hedge timing rules take precedence over the straddle rules for bona fide hedging transactions, we recommend that Treasury and the IRS expand the definition of a hedging transaction in Treasury regulations section 1.1221-2(b) to conform to the definition of a bona fide hedging transaction.

J. Modification of Reportable Transaction Rules

We recommend that the exceptions to the Reportable transaction rules be modified to include transactions that are covered by the election under proposed Treasury regulations section 1.988-7.

K. Issues Relating to the Act

Given the significant changes brought about by the Act, it is reasonable to consider what (if any) impact the new legislation should have on the above-described recommendations. In particular, it is reasonable to consider whether there should be a 'business needs' exclusion for the GILTI regime introduced by the Act. As we discuss in more detail below, we do not recommend adding a business needs exclusion to the GILTI regime.

IV. **DISCUSSION**

A. Application of the Proposed Regulations to Aggregate Hedges

While the Proposed Regulations addressed issues relating to property that could generate both subpart F and non-subpart F income, it is not clear that they fully address aggregate hedges (that is, where a hedge relates to a net exposure arising from multiple assets, some generating subpart F income and some not).

As an example, suppose a CFC with the U.S. dollar as its functional currency sells products in exchange for euros and pays some expenses in euros and, as a result of these transactions, the CFC has exposure to €100 receivables. If more than 10 euros of receivables generate foreign base company sales income, there is a concern that the IRS would argue that the business needs exclusion does not apply. We believe that the final regulations should address this issue. Specifically, if only 10% of the receivables generate foreign base company sales income, then only 10% of the hedge should fail to qualify for the business needs exclusion. In other words, the pro rata approach of the Proposed Regulations should be expanded to cover aggregate hedges and not merely hedges of individual positions.

B. Issues Regarding Proposed Regulation Section 1.988-7

We applaud Treasury and the IRS for considering this common-sense timing rule. Among other things, it will better align the tax rules with the GAAP remeasurement rules.

Nevertheless, proposed Treasury regulations section 1.988-7 raises several questions, which we highlight below.[29]

1. Coordination With Treasury Regulations Section 1.446-6

The first question is how an election under that section coordinates with Treasury regulations section 1.446-4 where the taxpayer is not a section 475 dealer and the relevant section 988 transaction is not a section 1256 contract.[30] Specifically, where a section 988 transaction entered into by an entity that elects to mark section 988 transactions to market under proposed Treasury regulations section 1.988-7 constitutes a hedging transaction under Treasury regulations section 1.1221-2 with respect to an item that is not marked-to-market, a question is presented as to whether the timing rules of Treasury regulations section 1.446-4 or proposed Treasury regulations section 1.988-7 takes precedence. That the specific exceptions[31] to the mark-to-market regime in proposed Treasury regulations section 1.988-7 do not include any reference to Treasury regulations section 1.446-4 supports the view that the 1.988-7 takes precedence as the rules are currently drafted, but that result is not clear. We recommend that the interaction of these rules be expressly addressed in the final regulations. One potential approach to this question would be to permit taxpayers to elect to identify section 988 transactions that are marked-to-market under proposed Treasury regulations section 1.988-7 as hedging transactions and then exempt those transactions from Treasury regulations section 1.446-4, in which case the default rule would be that the section 1.988-7 election controls. This would be helpful if the taxpayer is hedging a position that is marked-to-market under section 475. Another approach would be to provide expressly that Treasury regulations section 1.446-4 supersede the mark-to-market regime under proposed Treasury regulations section 1.988-7. While this latter approach may be more user friendly, as it does not rely on the taxpayer to affirmatively "opt out" of the

[29] Section 988(d) describes the treatment of 988 hedging transactions as including and integrating any section 988 transaction and treating these transactions as a single transaction, or otherwise being treated consistently for purposes of subtitle A (income taxes). This language is consistent with the Conference Report that discusses section 988, which describes an intent for the regulations to address two categories of hedging transactions, one, a "narrow class of fully hedged transactions that are part of an integrated economic package through which the taxpayer … has assured itself of a cash flow that will not vary with movements in exchange rates," and a second category that involves, "transactions that are not entered into as an integrated financial package but are designed to limit a taxpayer's exposure in a particular currency …. Where appropriate, these regulations should provide for consistent treatment with respect to character, source and timing." S. Rep. No. 99-514, at 666–67 (1986) (Conf. Rep.) (emphasis added). There could be a question of whether Prop. Treas. Reg. §1.988-7 (or its predecessor, withdrawn Prop. Treas. Reg. §1.988-5(f)), could pass muster under *State Farm's* "reasoned decisionmaking" understanding of the clause prohibiting "arbitrary" or "capricious" agency action. *See Motor Veh. Mfrs. Ass'n v. State Farm Ins.*, 463 U.S. 29 (1983); Whether or not Prop. Treas. Reg. §1.988-7 would satisfy the *State Farm* standard may purely be an academic exercise as it is unclear who would object to a taxpayer making this election.

[30] A section 988 transaction that is excepted from mark-to-market treatment under section 475 or section 1256 pursuant to an election or identification is not marked-to-market under proposed Treasury regulations section 1.988-7. In such a case, Treasury regulations section 1.446-4 presumably controls the timing on the section 988 transaction if it is a hedging transaction under Treasury regulations section 1.1221-2(b).

[31] Proposed Treasury regulations section 1.988-7(b) generally provides that the mark-to-market election in section 1.988-7(a) does not apply to (i) securities, commodities or section 1256 contracts that are marked-to-market under another provision, (ii) securities commodities or section 1256 contracts that are excepted from mark-to-market treatment under another provision pursuant to an election or identification, (iii) any transaction of a section 987 QBU and (iv) any section 988 transaction that is denominated in or references a hyperinflationary currency.

Treasury regulations section 1.988-7 on a case by case basis, in certain cases the approach may limit the utility and simplicity of the proposed Treasury regulations section 1.988-7 election.[32] Regardless of how these rules are coordinated, we believe it is important to include an express coordination rule to address the interaction of proposed Treasury regulations section 1.988-7 and Treasury regulations section 1.446-4.

2. Application of Appropriate Adjustments Requirement

Another issue relates to the requirement in the Proposed Regulations that "appropriate adjustments" be made to prevent the section 988 gain or loss recognized under the Treasury regulations section 1.988-7 regime from being taken into account again under section 988 or another provision of the Code or the regulations. This issue is complicated by the rule in Treasury regulations section 1.988-2(b)(8) that limits recognition of section 988 gain or loss to overall gain or loss in the context of a debt instrument. Treasury regulations section 1.988-7 contains no such limitation, which is consistent with GAAP's remeasurement process.

We recognize the reason for not incorporating the Treasury regulations section 1.988-2(b)(8) limitation. Nevertheless, it is not altogether clear what "appropriate adjustments" the Proposed Regulations expect taxpayers to make. Section 1256(a)(2), which is referenced in the Proposed Regulation, simply contemplates an "adjustment" to gain or loss subsequently realized on a section 1256 contract that is marked-to-market.[33] This adjustment does not affect the taxpayer's basis in the relevant section 1256 contract but rather affects the *amount* of gain or loss subsequently realized on the Section 1256 contract. Where a section 988 transaction can only give rise to section 988 gain or loss, an adjustment to the amount of gain or loss subsequently realized on the section 988 transaction to account for gain or loss previously recognized under proposed Treasury regulations section 1.988-7(a) is straightforward. Where the section 988 transaction in question can give rise to items that are not section 988 gain or loss (*i.e.,* gains due to rising interest rates or losses due to borrower's creditworthiness), however, there is uncertainty regarding the mechanism for making the adjustment. It is possible that, if marking-to-market results in gain being recognized, there should be an upward adjustment or, if loss is recognized, there should be a downward adjustment. However, this understates the possibility of there being no economic gain or loss on the debt instrument. The result of a subsequent sale in this situation is that a loss or gain would be recognized, resulting in a character mismatch. Gain under section 988 would be ordinary whereas gain or loss on the debt instrument might be capital. For example, assume a taxpayer owned a loan receivable with an inherent foreign currency gain of $100 but (due to the borrower's financial difficulties) the instrument was worth $100 less than when it was issued— yielding a net zero change in value. Under the Treasury regulations section 1.988-7 elective regime, the foreign currency gain would presumably be reflected in basis. The taxpayer's basis would increase by $100. Assuming the currency appreciation and borrower's financial difficulties remain constant and the debt instrument were

[32] For example, some taxpayers may rely on the election to cause foreign currency derivatives entered into with related foreign parties to be marked-to-market for purposes of treating payments on the derivatives as qualified derivative payments under section 59A(h). This may not be possible if Treasury regulations section 1.446-4 overrides proposed Treasury regulations section 1.988-7 in all cases.

[33] The flush language of section 475(a) contemplates similar adjustments with respect to gain or loss realized on securities marked under section 475.

later sold, the taxpayer would recognize a $100 loss. The loss, if the taxpayer is not a dealer, would be capital. The question is whether such a consequence was intended.

While this is a theoretical possibility, if the taxpayer holding the debt instrument is a dealer, gain or loss would generally be ordinary. In the case where the taxpayer is not a dealer, rather than making a basis adjustment, an alternative might be to require the taxpayer to use a memorandum account to record the adjustment and to release the adjustment upon a later disposition. This could be achieved by an adjustment to the previously recognized section 988 gain or loss.[34]

Similar issues arise in the situation in which the election is made, but the taxpayer making the Treasury regulations section 1.988-7 election is the obligor on the debt instrument. In that case, gain or loss (other than that relating to section 988 gain or loss) would also either be ordinary or an adjustment to interest expense similarly resulting in a matching of character. Although there is less practical significance to this situation given the character match, we recommend Treasury and the IRS provide an example illustrating application of the mechanics of the adjustment so that the timing result is clearer.

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[34] As an example, consider the case where section 988 gain is recognized, but the underlying position is disposed of at a loss. In such case, the gain limitation rule should apply to cause a reversal of the previously recognized loss. For example:

> A taxpayer, X, uses the dollar as its functional currency and makes the Treasury regulations section 1.988-7 remeasurement election. At the beginning of year 1, X pays €100,000 for a debt instrument when the spot rate is €1 = $1.00. The issuer will make interest payments of €50 on the last day of year 1, year 2 and year 3 and will repay the €100,000 principal on the last day of year 3. The year 1, year-end rate is equal to €1 = $1.02. X sells the bond on the first day of year 2 for €97,000 after the interest payment when the spot rate is €1 = $1. 02.. At the end of year 1, X recognizes exchange gain on a mark-to-market basis equal to $2,000 (€100,000 x $1.02) – (€100,000 x $1.00). If the value of the debt instrument at the end of year 1 is €98,000, the netting rule will not apply even though X has an overall loss of $40 (€98,000 x $1.02) – (€100,000 x $1.00) since the net rule does not apply when the election is made. The result is that X realizes $2,000 of exchange gain at the end of year 1.
>
> However, when X sells the instrument on the first day of year 2, the netting rule applies. Assuming that there was no basis adjustment and instead, the gain was recorded in a memorandum account, X's exchange gain on the €100,000 of principal is $2,000 (€100,000 x $1.02) – (€100,000 x $1.00), but this is limited to the total gain (loss) on the transaction, ($1,060) (€97,000 x $1.02) – (€100,000 x $1.00). The result is that X should realize $0 of exchange gain and $1,060 market loss with respect to the transaction. X realized $2,000 of exchange gain on the last day of year 1 and, after making proper adjustments, X realized $2,000 of exchange loss and $1,060 of market loss on the first day of year 2 when X sold the debt instrument. X's net exchange gain or loss over the life of the transaction, $0, is equal to the exchange gain or loss that X would have recognized but for the mark-to-market election.

See ICI Seeks Clarification of Proposed Regs on Mark-to-Market Election, Tax Notes (Mar. 20, 2018), https://www.taxnotes.com/tax-notes-today/accounting-periods-and-methods/ici-seeks-clarification-proposed-regs-mark-market-election/2018/05/30/2833f?highlight=2018-22464.

3. Restrictions on Who May Make the Election

Another question is whether the Treasury regulations section 1.988-7 election is taxpayer by taxpayer or whether the election by one member of the consolidated group binds other members of the same consolidated group owned by the taxpayer.[35] A related question is whether the election can be made for one trade or business without being made by another. We note that under section 475(a), which is non-elective, dealer status applies on a taxpayer-by-taxpayer basis. Moreover, a trader election under section 475(f) is made for a trade or business and while not completely analogous, the taxpayer can identify certain securities for which the election does not apply if they are placed in a non-trading account.

In our experience, many U.S.-headed multinational organizations elect to treat significant numbers of foreign subsidiaries as disregarded entities for U.S. tax purposes in order to simplify their U.S. tax structure. These disregarded foreign subsidiaries may include a variety of business models (*e.g.*, limited risk distributor, manufacturer, financial center), and may be in different industries, and thus they may enter into section 988 transactions in a variety of different contexts and manage exposures with respect to those transactions in different ways. In the context of such tax structures, permitting the Treasury regulations section 1.988-7 election to be made on a trade or business basis would provide much needed flexibility. A countervailing consideration arises from the manner in which the election is made and revoked. Specifically, the election is made with the timely filed original tax return for the year in which the election is effective and initially can be made without restrictions, and then may be revoked at any time, which effectively provides a one-time opportunity to "cherry pick" foreign currency losses (*i.e.*, by making an initial election for a particular year after it is known that there are net foreign currency losses on section 988 transactions and then immediately revoking the election). Because of this, permitting the election to be made on a trade or business basis (rather than on a taxpayer-by-taxpayer basis) could be expected to increase the number of opportunities to "cherry pick" foreign currency losses. These opportunities will be limited, to some extent, by the rule in proposed Treasury regulations section 1.988-7(d) that generally precludes a taxpayer from making an election under that section for 5 years following any revocation of the election.

While it is important to allow taxpayers to have significant flexibility in this context, we believe it would be appropriate to constrain this flexibility to some extent to limit cherry picking. Final regulations could potentially require that this election be made on a broader, group-wide basis (*e.g.*, on a consolidated group basis, or on an expanded affiliated group (as defined in section 7874(c)(1)) basis). This would limit opportunities to cherry pick but would likely significantly reduce the utility of this election. Alternatively, final regulations could require that this election be made on a taxpayer-by-taxpayer basis, potentially subject to a requirement that the election be made consistently across different related taxpayers that are engaged in the same trade or business, in which case cherry picking would be limited to a lesser extent but much of the utility of the election would be preserved. Another alternative would be for Treasury and the IRS to permit the election to be made on a trade or business basis but provide a targeted anti-abuse rule with examples of instances in which it would be inappropriate to make the election on

[35] Proposed Treasury regulation 1.988-7(a) states that the election is made for "all section 988 transactions" but the Preamble only states that the election can be made for with respect to "section 988 transactions."

a trade or business basis (*e.g.*, a fact pattern where a taxpayer establishes a small trade or business in order to selectively recognize foreign currency losses).

4. Limitation on Application of Straddle Rules

The straddle rules of section 1092 can create timing mismatches where currency risk is hedged using derivatives that are not disposed of or terminated at the same time as the transaction being hedged. Where the proposed Treasury regulations section 1.988-7 election has been made, since the same timing rules would generally apply to the offsetting currency components of the position being hedged (at least where that position is a section 988 transaction) and the hedging instrument, there generally should be no need for straddle consequences.

As an example, assume a taxpayer has a foreign currency denominated bond that is hedged with derivative contracts. Assume that the derivative contract generates a loss and the foreign currency component of the foreign currency denominated bond generates a gain. Assume that the bond has appreciated in value due to changes in credit quality or interest rate movements. There would be no policy reason to defer the loss on the derivative on the basis of the unrealized gain that is not due to currency movements.

In sum, where the proposed Treasury regulations section 1.988-7 election has been made, it would make sense from a policy perspective for the straddle rules not to apply so long as the offsetting positions in foreign currency are both required to be marked-to-market under proposed Treasury regulations section 1.988-7. The straddle rules could still apply to positions that are outside the election.

5. Transitional Issues

Several transitional issues are raised by the proposed Treasury regulations section 1.988-7. First, the Proposed Regulations do not specify whether it is necessary for taxpayers who make the election under proposed Treasury regulations section 1.988-7 to file a Form 3115 (Application for Change in Accounting Method). The Proposed Regulations state that the election is made by filing a statement that clearly indicates that the election is made with the taxpayer's tax return for the applicable tax year and does not condition the election on approval by the IRS. This suggests that taxpayers are intended to have the freedom to make the election without navigating a significant administrative process, a judgment that we believe is appropriate. Consistent with this apparent intent, we recommend that Treasury confirm that an election under proposed Treasury regulations section 1.988-7 does not require the consent of the IRS or, alternatively, is a change in method of accounting for which the consent is automatically granted. Second, if the election is made, there is a question of whether a section 481(a) adjustment would be required with respect to any outstanding section 988 transactions that were entered into prior to the year for which the election is first effective. The Proposed Regulations do not state that a section 481(a) adjustment is required with respect to such transactions, and it would be simpler from an administrative perspective to simply recognize the full amount of imbedded foreign currency gain or loss with respect to such transactions when they are marked-to-market at the end of the first year for which the election is first effective. On the other hand, by analogy, a section 481(a) adjustment is required to be made in connection with elections

under section 475(e) or (f).[36] We recommend that Treasury and the IRS expressly confirm whether a section 481(a) adjustment is required in connection with an election under proposed Treasury regulations section 1.988-7.

C. Clarification of the Allocation Rule in the Business Needs Exclusion

In the case of foreign currency gain or loss arising from a transaction or property that gives rise to both subpart F income (other than foreign currency gain or loss) and non-subpart F income, or a bona fide hedging transaction with respect to such a transaction or property, and that otherwise satisfies the requirements of the business needs exclusion, the Proposed Regulations provide that the amount of foreign currency gain or loss that is allocable to non-subpart F income is directly related to the business needs of the relevant CFC. Under the Proposed Regulations, the amount of such foreign currency gain or loss that is allocable to non-subpart F income equals, "the product of the total amount of foreign currency gain or loss arising from the transaction or property and the ratio of non-subpart F income (other than foreign currency gain or loss) that the transaction or property gives rise to, or is reasonably expected to give rise to, to the total income that the transaction or property gives rise to, or is reasonably expected to give rise to."[37]

Two questions are raised by this description of the ratio that is used to compute the amount of foreign currency gain or loss that is allocable to non-subpart F income. The first is whether the income described in the numerator and the denominator of the ratio reflects the total expected income over the entire duration of the transaction, or is instead intended to reflect only the expected income for the applicable tax year. The former interpretation appears to be intended, but we recommend that Treasury and the IRS confirm this (*i.e.*, if a CFC's total expected income changes from one year to the next, it would be appropriate to use the expected income of the CFC at the time of testing).

The second question is whether foreign currency gain or loss, which is expressly excluded from the numerator of the ratio, should be excluded from the denominator of the ratio. Read literally, it appears that foreign currency gain or loss is included in the denominator because it is a component of the total economic income of the transaction or property. Inclusion of foreign currency gain or loss in the denominator, however, would result in the percentage of foreign currency gain or loss that is attributable to non-subpart F income varying depending upon the magnitude of the foreign currency gain or loss relative to the other types of income from the transaction or property. For example, assume that a CFC holds a non-functional currency debt instrument that gives rise to $50 of foreign currency gain that would qualify for the business needs exclusion except that the instrument is expected to give rise to $100 of interest income, $50 of which is subpart F income (other than foreign currency gain or loss). If foreign currency gain or loss is included in the denominator (but not the numerator) of the ratio, approximately 33% (or $16.67) of the foreign currency gain would be treated as attributable to non-subpart F income (*i.e.*, $50 x $50/$150). Alternatively, if the amount of foreign currency gain on the same instrument were $25, approximately 40% (or $10) of the foreign currency gain would be treated

[36] Rev. Proc. 99-17, 1999-1 C.B. 503.

[37] Prop. Treas. Reg. §1.954-2(g)(2)(ii)(C).

as attributable to non-subpart F income (*i.e.*, $25 x $50/$125). It is not entirely clear why the relative magnitude of the foreign currency gain or loss should affect the percentage of that gain or loss that is treated as attributable to non-subpart F income. In addition, in the case of a foreign currency loss, inclusion in the denominator could produce peculiar results. For example, assume that a CFC holds a non-functional currency debt instrument that gives rise to $99 of foreign currency loss that would qualify for the business needs exclusion except that the instrument is expected to give rise to $100 of interest income, $50 of which is subpart F income (other than foreign currency gain or loss). If foreign currency gain or loss is included in the denominator (but not the numerator) of the ratio, the amount of foreign currency loss that would be allocable to non-subpart F income would be -$4,950 (*i.e.*, -$99 x $50/($100-$99)), which greatly exceeds the overall amount of the foreign currency loss.

On the other hand, if foreign currency gain or loss is excluded from the denominator (as well as the numerator) of this ratio, the percentage of that gain or loss that is treated as attributable to non-subpart F income would not depend on the relative magnitude of the foreign currency gain or loss, and the absolute value of that amount attributable to non-subpart F income would never exceed the absolute value of the amount of foreign currency gain or loss. We recommend that Treasury and the IRS clarify whether the denominator of this ratio is intended to exclude foreign currency gain or loss.

D. Incorporation of Risk Management Standard for Purposes of the Business Needs Exclusion

Some practitioners have questioned whether the business needs exclusion has incorporated the "risk management" standard that was added to the regulations under section 1221 in 2002. In particular, some have taken the view that because of a statement in the preamble to the Treasury regulations section 1.1221-2, the bona fide hedging transaction definition in Treasury regulations section 1.954-2(a)(4)(ii) implicitly incorporates the former "risk reduction" standard, which is less flexible than the current "risk management" standard reflected in Treasury regulations section 1.1221-2 and in section 475(c)(3).[38] However, the cross reference to Treasury regulations section 1.1221-2 in the bona fide hedging transaction definition could alternatively be interpreted to incorporate the risk management standard. We believe it is appropriate for the risk management standard to apply for purposes of the business needs exclusion, especially in light of the complex issues implicated by QBU-related hedging transactions, and we recommend that Treasury expressly confirm that the risk management standard has been adopted for these purposes. We believe such a change would be in the nature of a technical correction.

[38] *See* BNA portfolio 6220-1st, IV.C.2 (noting that the preamble to the regulations under section 1221 provided that "subsequent regulations will specify the extent to which the rules that are contained in section 1.1221-2 will be applicable for purposes of [other international] regulations and the related Code provisions" and concluding that the risk reduction standard "apparently [applies] for Subpart F purposes until Treasury affirmatively adopts the new risk management regulations for Subpart F purposes.") (citing T.D. 8985, 67 Fed. Reg. 12863 (3/20/02)); *See also* New York State Bar Association Tax Section Report No. 782, Report on Proposed and Temporary Regulations on Character and Timing of Gains and Losses from Hedging Transactions (March 4, 1994), pages 40-45 (comparing the risk reduction and risk management standards); *cf.* Prop. Treas. Reg. § 1.1221-2, 67 Fed. Reg. 12829, 12863 (Mar. 20, 2002) (withdrawn) (hedging defined to include risk reduction), with Treas. Reg. § 1.1221-2 (as amended in 2007).

E. Effective Date Issues

The final regulations or some other guidance should address questions regarding the applicability date in the Preamble to proposed Treasury regulations section 1.988-7 as there are multiple ways to read the reliance provision. One reading points to the background section of the Preamble, which says "this document contains proposed amendments to 26 CFR part 1 under sections 446, 954(c)(1)(D), and 988 of the Code." The inclusion of section 988 would suggest that the reliance provision would also include proposed Treasury regulations section 1.988-7 and should also be effective for taxable years ending after December 17, 2017. On the other hand, the Preamble can be read to say that only the proposed amendments under sections 446 and 954(c)(1)(D) are amendments and the change under section 988 is the addition of an entirely new provision, proposed Treasury regulations section 1.988-7. This second reading would exclude proposed Treasury regulations section 1.988-7 from the reliance provision. There have been conflicting statements by government officials on this point.[39] We note that because of changes to the corporate tax rate under the Act, whether taxpayers are permitted to apply the regulations to their 2017 tax years is particularly significant.[40]

We recommend that Treasury and IRS allow calendar year taxpayers to apply the regulations to their 2017 tax years.

F. Modification of the Hedge Timing Rules

The Proposed Regulations seeks comments relating to the timing of gain or loss on hedges with respect to section 987 QBUs. The specific question is whether the hedge timing rules should be expanded with respect to section 987 QBUs when no annual deemed termination is in effect, and if so, how the appropriate matching should be achieved. While the issue is posed in the context of the Final 987 Regulations, a similar issue arises under the 1991 Proposed Regulations.

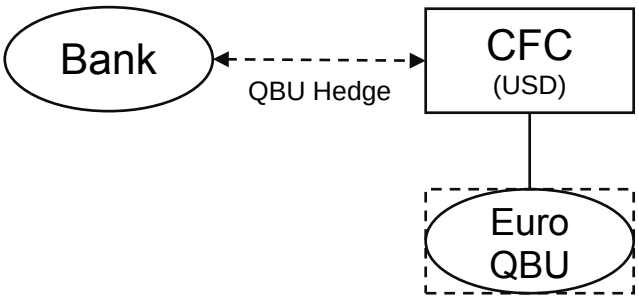
Example 1:

Assume a CFC with a functional currency of the U.S. dollar enters into a QBU Hedge with respect to its net investment in a QBU that has the euro as its functional currency ("**Euro QBU**"). The hedge constitutes a financial statement hedging transaction under proposed Treasury regulations section 1.954-2(g)(2)(ii)(C)(2). The CFC enters into the QBU Hedge when the U.S. dollar euro exchange rate is $1 to €1. Assume further than that the QBU Hedge consists

[39]Tax Notes, IRS Official Settles Confusion on Proposed MTM Election, May 11, 2018, available at: https://www.taxnotes.com/worldwide-tax-daily/accounting-periods-and-methods/irs-official-settles-confusion-proposed-mtm-election/2018/05/14/281lm ("Erwin said in January that taxpayers could rely on the new section 988 mark-to-market election and make the election for 2017 returns….But in February, a Treasury official contradicted Erwin and said he didn't believe the new mark-to-market rule could be relied on yet.").

[40] In Notice 2018-26, Treasury and the IRS announced their intent to issue regulations under which a change in method of accounting for a tax year of a specified foreign corporation that ends in 2017 or 2018 is generally disregarded for purposes of determining transition tax liability under section 965 unless an application for a change in accounting method was filed before November 2, 2017. Under this rule, it appears that an election under proposed Treasury regulations section 1.988-7 for the 2017 tax year would not have the effect of reducing transition tax liability.

of a forward contract to sell €100 for $100 at the end of a two-year period and that at the end of year two, the USD euro exchange rate is $1 to €1.5. Accordingly, at the end of two-year period, the CFC will have realized a cumulative gain of $33.33 on the QBU Hedge. Finally, assume that at the end of year two, Euro QBU distributes €20 (10% of the Euro QBU's equity pool) to the CFC, immediately prior to which, under the 1991 Proposed Regulations the CFC has a basis pool equal to $200 and an equity pool equal to €200 (with an unrealized loss of $66.67, *i.e.*, €200 x $1/€1.5 - $200) with respect to Euro QBU, triggering $6.66 of section 987 loss under the 1991 Proposed Regulations.[41]



Under proposed Treasury regulations section 1.954-2(g)(2)(ii)(C)(2), the qualifying portion of the $33.33 of gain realized on the QBU Hedge that is allocable to non-subpart F income is directly related to the business needs of a CFC. The issue is when the gain on the QBU Hedge should be recognized. We outline several possible approaches below.

One possibility (and the approach we recommend) is that the timing of recognition of gain or loss on the QBU Hedge could be matched to the timing of recognition of section 987 gain or loss with respect to the Euro QBU. This could be accomplished by simply adding the gain or loss on the hedge to the unrecognized section 987 gain or loss associated with the QBU.[42] For example, upon a remittance from the Euro QBU, a percentage of the gain or loss realized on the QBU Hedge equal to the percentage of the unrecognized section 987 gain or loss that is recognized as a result of the remittance could be recognized. On the facts described above, such a rule would mean that at the end of year two, when $6.66 of section 987 loss is recognized, which represents 10% of the unrecognized section 987 loss with respect to Euro QBU that exists at that time, $3.33 of the gain realized on the QBU Hedge (*i.e.*, 10% of the realized gain) would be recognized.[43] This approach has some conceptual appeal because it ties the timing of items

[41] €20 x $1/€1.5 - €20/€200 x $200.

[42] How that occurs mechanically depends on what approach Treasury and the IRS decide to take under the section 987 regulations. Under the Final 987 Regulations, the gain or loss could simply be added to the "net unrecognized section 987 gain or loss" account. In this regard, if Treasury and the IRS decide to retain the distinction between "historic" and "marked" assets then the rules would presumably need to first bifurcate the gain or loss on the hedge into the portion that relates to "historic" assets and the portion that relates to "marked" assets. Only the portion that relates to "marked" assets would be added to the "net unrecognized section 987 gain or loss". The portion relating to "historic" assets would have to be added to or subtracted from the CFC's basis in those assets using some method. Under the 1991 Proposed Regulations, the same result could be achieved by reflecting the gain or loss in the basis pool, without any bifurcation of the gain or loss.

[43] Under current law, it appears that the straddle rules could potentially apply to any loss recognized on a QBU Hedge. Pursuant to section 1092(e), the straddle rules do not apply to properly identified hedging transactions described in section 1221(b)(2)(A). In many cases, however, it may be difficult to conclude that a QBU Hedge is a

on the QBU Hedge to the timing of recognition of section 987 gain or loss, which in a very general sense reflects the economic exposure that is being hedged by the QBU Hedge. We note, however, that if an "earnings only" approach to complying with section 987 is followed, section 987 gain or loss may not correspond fully to the economic exposure that is being hedged, in which case we would recommend that the matching rule not apply to the QBU Hedge.[44] In addition, in some cases it may be complicated to match items on the QBU Hedge to the "right" section 987 gain or loss if less than all of the unrecognized section 987 gain or loss of the Euro QBU is recognized after the QBU Hedge terminates.[45] An alternative way of matching the timing or gain or loss realized on the QBU Hedge to recognition of section 987 gain or loss with respect to the Euro QBU would be to require the CFC to recognize gain or loss realized on the QBU Hedge to the extent that section 987 loss or gain is recognized, respectively. On the facts described above, such a rule would mean that at the end of year two, when $6.66 of section 987 loss is recognized, $6.66 of the gain realized on the QBU Hedge would be recognized. This alternative would simplify application of the rule but would tend to cause items on the QBU Hedge to be recognized earlier than would be the case under the first possibility, particularly where the QBU Hedge represents a hedge of only a portion of the CFC's net investment in the Euro QBU.

A second possibility would be to defer recognition of items of gain or loss on the QBU Hedge until the termination of the QBU. On the facts described above, such a rule would mean that all of the gain that was realized on the QBU Hedge at the end of year two would be deferred until such time as the Euro QBU is terminated for tax purposes. This rule would be relatively simple to apply and administer, and in some instances, we would expect it to result in a significant degree of matching. However, to the extent that section 987 gain or loss reflects the hedged economic exposure is recognized prior to the termination of the QBU, the rule would result in a timing mismatch. In addition, the rule would introduce a degree of electivity, which could be undesirable if a significant portion of the hedged exposure will not be reflected in section 987 gain or loss that would be triggered by a termination of the QBU.[46]

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hedging transaction within the meaning of 1221(b)(2)(A) (*e.g.*, because the hedged items may not be ordinary property). Specifically, the section 1221 regulations require that a disposition of the underlying property not give rise to income other than ordinary income. Yet, a disposition of the QBU's hedged items may give rise to capital gains/losses, and not just ordinary property. Nevertheless, the hedges in this case are clearly designed to hedge only the "currency exposure" associated with the QBU. That exposure is recognized (under U.S. tax law) under section 987, and the gain or loss is considered "ordinary." The same issue is presented in Example 2 and Example 3 described below. As noted above, we recommend that Treasury and the IRS expressly except bona fide hedging transactions described in Treasury regulations section 1.954-2(a)(4)(ii) from the straddle rules.

[44] If a CFC applies an "earnings only" version of the 1991 Proposed Regulations, the section 987 gain or loss that could potentially be recognized by the CFC (even upon a termination of the QBU) would not reflect the entire economic exposure that would be hedged by a net-investment hedge. This issue would not be presented under the original version of the 1991 Proposed Regulations or under the Final 987 Regulations (so long as, in the case of the Final 987 Regulations, gain or loss on the hedge is bifurcated in the manner described above in note 38. This is an instance where the manner in which section 987 is applied may impact the approach that should be taken to the timing of items on a QBU Hedge.

[45] For example, adjustments might need to be made to account for capital contributions to the QBU and changes in the unrecognized section 987 gain or loss that arises, after the QBU Hedge terminates.

[46] This could occur if, for example, because the CFC applies the "earnings only" version of the 1991 Proposed Regulations or the Final 987 Regulations.

A third possibility would be to defer recognition of items of gain or loss on the QBU Hedge until such items are recognized in the applicable income financial statement for GAAP purposes. This approach would make sense if, for example, Treasury and the IRS decide to: (i) depart from the 1991 Proposed Regulations and the Final Section 987 Regulations; and (ii) better align the section 987 rules for measuring and recognizing section 987 gain or loss with the GAAP rules for measuring and recognizing the CTA account. On the facts described above, such a rule would mean that all of the gain that was realized on the QBU Hedge at the end of year two would be deferred until there was a realization event with respect to the Euro QBU for GAAP purposes. It would also be most consistent with the corporate rationale for undertaking the transaction. This rule would be relatively simple to apply and administer and would not entail significant taxpayer electivity. While the rule could potentially result in timing mismatches (*e.g.*, if Euro QBU was terminated in an internal restructuring transaction that did not result in recognition for GAAP purposes), such mismatches may be preferable to the volatility in subpart F income/GILTI that could arise in the absence of any matching rule. A variation on this alternative would simply be to adjust the equity pool for the relevant gain or loss on the QBU Hedge.

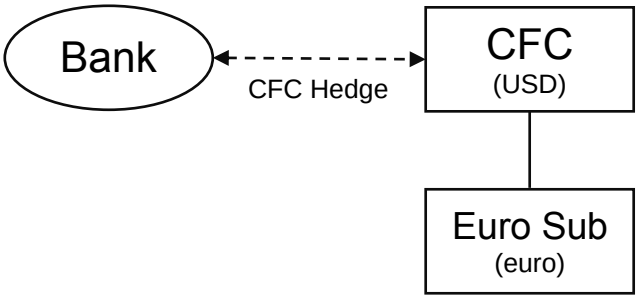
A fourth possibility would be to simply allow ordinary timing rules to control the recognition of items on the QBU Hedge. On the facts described above, such a rule would mean that gain or loss that would be recognized on the QBU Hedge at the end of each of year one and year two under section 1256, which requires that such contracts be marked to market. While this rule would be relatively simple to apply and administer, it would likely result in significant mismatches and volatility in subpart F income/GILTI over time (*i.e.*, as QBU Hedges mature and are rolled over).

G. Expansion of the Business Needs Exclusion for CFC Investment in a CFC

The second question the Preamble raises relates to the application of the business needs exclusion to a transaction that is entered into for the purposes of managing the risk of foreign currency fluctuation with respect to a CFC's net investment in a subsidiary. Such a transaction would not otherwise qualify as a bona fide hedge as the asset being hedged is a capital asset. The question further asks how gain or loss on such a transaction "could or should be" allocated between subpart F income and non-subpart F income and how the currency gain or loss could be matched with the foreign currency gain or loss on the "hedged item."

Example 2:

Assume a CFC with a functional currency of the U.S. dollar enters into a hedging transaction ("**CFC Hedge**") with respect to its net investment in a regarded corporate subsidiary ("**Euro Sub**"), which would constitute a financial statement hedging transaction under proposed Treasury regulations section 1.954-2(g)(2)(ii)(C)(2) if Euro Sub were a section 987 QBU rather than a regarded corporate subsidiary. Assume further that Euro Sub has the euro as its functional currency and that it has €100 of earnings and profits as of the end of year two. Assume the facts are otherwise the same as Example 1.



We believe that the business needs exclusion should be broadened to include the CFC Hedge. As is the case with QBU Hedges, CFC Hedges are typically non-speculative transactions entered into in order to hedge financial statement exposures.[47] It would be consistent with the legislative history of the business needs exclusion to include both QBU Hedges and CFC Hedges within the scope of the exception.[48] Moreover, it would appear to be desirable from a policy perspective to treat net investment hedges in a broadly similar way for purposes of the business needs exclusion, regardless of the tax classification of the subsidiary whose equity is hedged. In addition, we believe that it is appropriate to expand the business needs exclusion to include CFC Hedges relating to CFCs that are *indirect* subsidiaries of the CFC.[49] Expansion of the business needs exclusion seems appropriate given that income from a transaction that meets the business needs exclusion will most likely be subject to the GILTI regime, and not escape current taxation.

If the business needs exclusion is broadened to include CFC Hedges, two further questions will need to be addressed.

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[47] We note that the Proposed Regulations appear to adequately address the timing and subpart F matching issues that are raised by hedges of nonfunctional currency debt investments in related CFCs. Specifically, under Proposed Regulation section 1.954-2(g)(2)(ii)(C), foreign currency gain or loss on a nonfunctional currency debt instrument that gives rise to subpart F income (other than foreign currency gain or loss) and that is otherwise within the scope of the business needs exception is in effect allocated between subpart F income and non-subpart F income based on the proportion of income from the debt instrument that is treated as subpart F income. Until section 954(c)(6) sunsets, interest paid on a debt instrument issued by a related CFC will generally be allocated between subpart F income and non-subpart F income based on the subpart F income profile of the CFC that issued the debt. Foreign currency gain or loss on a hedge of such a debt instrument will be allocated between subpart F income and non-subpart F income in the same manner, resulting in matched subpart F treatment of foreign currency gain or loss on the hedge and debt instrument.

[48] The legislative history of the business needs exclusion suggests that Congress did not intend for foreign currency gain or loss on non-speculative transactions entered into by a CFC to be subject to current U.S. taxation under subpart F. Congress believed that income from trading in foreign currencies represents the type of income that can easily be routed through a controlled foreign corporation in a tax haven jurisdiction. Therefore, the excess of foreign currency exchange rate gains over foreign currency exchange rate losses should generally be subject to current U.S. taxation under subpart F unless directly related to the business needs of the corporation. Staff of the Joint Committee on Taxation, General Explanation to the Tax Reform Act of 1986, 99th Cong. 2d. Sess. at 966 (Joint Comm. Print 1987). *See also* H.R. REP. NO. 426, 99th Cong., 1st Sess. 391, 392; and S. Rep. No. 313, 99th Cong., 2d Sess. 364.

[49] Net investment hedges may sometimes be centralized in a single CFC that is an indirect parent in order to achieve efficiencies where only a net exposure needs to be hedged. The purpose of such hedges is the same regardless of whether the CFC is the direct or indirect parent of the CFC whose equity is being hedged.

The first question is how gain or loss on a CFC Hedge should be allocated between subpart F income and non-subpart F income in order to best match the subpart F characterization of the hedged exposure. One approach (and the approach that we recommend)[50] would be to permit taxpayers to elect to capitalize gain or loss on the CFC Hedge into the basis of the stock of the CFC.[51] In addition to affecting the timing of the recognition of gain or loss (as discussed below), this approach would in effect cause the subpart F treatment of such gain or loss to be matched to the subpart F treatment of any gain or loss realized on the disposition of the stock of the CFC. To the extent that a CFC Hedge relates to income that will be distributed (and which may generate gain or loss under section 986(c)), capitalization may not result in a matching of items on the CFC Hedge to the hedged item. For this reason, we believe it is important that capitalization be an elective regime.[52] If an elective capitalization regime is adopted, we recommend that Treasury and the IRS consider allowing taxpayers that do not elect to capitalize gain or loss of a CFC Hedge to apply one of the alternative allocation (and timing) rules described below. One alternative approach would be to exclude all gain or loss on a CFC from subpart F income. A rationale for this approach would be that a CFC Hedge is a non-speculative transaction the gain or loss from which should not, as a policy matter, be treated as passive-type gain or loss that is included in the computation of FPHCI. In addition, this would be a very simple approach that may in practice yield acceptable matching of subpart F characterization where the assets that are economically hedged do not give rise to significant amounts of subpart F income. Another alternative approach would be to allocate gain or loss on a CFC Hedge based on the value of the assets of Euro Sub under the principles of section 861. These principles are well understood and could likely be applied without undue difficulty. Either fair market value or tax basis could be used to measure the CFC's assets. Fair market value may be a less arbitrary

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[50] Our recommendation of this approach raises a question about whether a similar approach should be taken to the treatment of net investment hedges entered into by U.S. corporations with respect to regarded foreign subsidiaries. While the character issues raised by such hedges are somewhat different from the subpart F and GILTI issues raised by CFC Hedges, the policy considerations are broadly similar – in each case, it is generally desirable from a policy perspective to match the treatment and timing of the underlying items on the hedge and the hedged item (*i.e.*, the equity of the subsidiary). A discussion of potential changes to the treatment of net investment hedges entered into by U.S. corporations is beyond the scope of this Report, but we believe further consideration of this issue would be merited. As noted earlier, the New York State Bar Association Tax Section Report No. 656 issued in 1990 had addressed the treatment of net investment hedges made by a U.S. parent of its CFC and recommended that an adjustment to the amount of income realized by the taxpayer in respect of actual or deemed distributions from the foreign subsidiary be permitted.

[51] If this approach is adopted, however, consideration would have to be given to what would happen if there were a gain realized on the CFC Hedge that exceeded the relevant CFC's basis in the stock of the subsidiary (*i.e.*, such that an adjustment to basis would yield a negative number). For example, assume CFC1 owns CFC2 and CFC1 has a $100 basis in CFC2. If CFC1 realizes a loss with respect to its net investment hedge of CFC2's stock, CFC1 would presumably add that loss to its basis in the stock of CFC2. But if CFC1 realizes a gain of $110, then CFC1 would presumably reduce its basis in CFC2 and consideration would have to be given to what happens to the extra $10. One potential approach would be to require the taxpayer to use a memorandum account to record the extra $10 of gain and release the adjustment upon a later taxable disposition of the stock of CFC 2.

[52] In addition, further consideration to proposed Treasury regulations section 1.988-5(d) may have merit. That regulation, which was proposed in 1992, would general permit the integration of hedges of declared but unpaid nonfunctional currency dividends with the underlying dividends to which they relate. Integration by its nature would result in a matching of timing and subpart F treatment. Finalization of that regulation, in conjunction with adoption of an elective capitalization regime, would provide taxpayers with significant flexibility to address timing and subpart F characterization issues associated with hedges of equity and earnings of CFCs.

metric. Conversely, an allocation based on tax basis may yield somewhat arbitrary results but may be relatively easy to comply with and less susceptible to manipulation by taxpayers. Another alternative approach would be to allocate gain or loss on a CFC Hedge based on the income profile of Euro Sub under, for example, the principles of Treasury regulations section 1.861-9T(j).[53] Which of these approaches best matches the allocation of gain or loss on a CFC Hedge to the subpart F characterization of the hedged exposure may be context-dependent and may depend on the timing of the items. We believe it is worth considering to allow taxpayers flexibility to choose an allocation method subject to a requirement that the chosen allocation method be applied consistently, such that taxpayers are afforded the greatest opportunity to minimize tax volatility arising from CFC Hedges. Given that at the time CFC Hedges are entered into it is unlikely to be known whether any particular CFC Hedge will result in gain or loss, it would seem that such flexibility would afford little opportunity for the government to be whipsawed by taxpayers, provided taxpayers are constrained by a consistency requirement.

The second question is when gain or loss on a CFC Hedge should be recognized. Approaches analogous to those described in the case of a QBU Hedge could potentially be taken in the case of a CFC Hedge. However, the considerations are somewhat different in this context, which may imply that a different approach to timing would be appropriate in the case of a CFC Hedge.

As described above, one possible approach (and the one that we recommend) would be to permit taxpayers to elect to capitalize gain or loss on the CFC Hedge into the basis in the stock of the CFC (*i.e.*, if there is gain on the CFC Hedge, the basis in the stock of the CFC is reduced, and vice versa). The effect would be to match recognition of items of gain or loss on the CFC Hedge to the recognition of gain or loss with respect to the stock of the CFC upon its taxable disposition. Such an approach would be very much like integration which is permitted for hedging transactions under certain fact patterns.[54] On the facts described above, such a rule would mean that all of the gain that was realized on the CFC Hedge at the end of year two would be deferred until such time as the stock of Euro Sub is disposed of in a taxable transaction. Of course, in many instances the disposition of the stock of a CFC may be tax-free (*e.g.*, as a result of a tax-free liquidation) and may not trigger any built-in gain or loss in the assets of the Euro Sub. Moreover, this will tend to increase differences between inside and outside basis. On the other hand, such an approach would be easy to implement.[55]

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[53] P.L. 115-97 amended section 864(e)(2) to prohibit the allocation of interest expense based on the fair market value of assets or gross income. Prior to this amendment, it was permissible to compute a CFC's subpart F income by allocating its interest expense based on the income profile of the CFC under Treasury regulations section 1.861-9T(j). The revision of this rule was likely due to budgetary considerations as the allocation of interest expense is an important issue in the foreign tax credit area. Notwithstanding this change in the permissibility of this method for purposes of interest expense allocation, we believe this allocation method may have merit for purposes of allocating gain or loss on a CFC Hedge. Furthermore, we note that the possibility that any given CFC Hedge will give rise to *gain* or loss distinguishes this allocation question from the question of how interest expense, which only reduces income, should be allocated.

[54] *See* Treas. Reg. §§ 1.1275-6 and 1.988-5.

[55] This approach is suggested in a thoughtful article on foreign currency related issues. *See* John McDonald, et al; *The Devil is in the Details. Problems, Solutions and Policy Recommendations with Respect to Currency Translation, Transactions and Hedging*, 89 Taxes 199 (2011) pages 247 and 265 (discussing net investment hedges

Another possibility would be to match timing of items on the CFC Hedge to distributions by the Euro Sub. For example, upon a distribution of earnings from the Euro Sub to the CFC, a percentage of the gain or loss realized on the QBU Hedge equal to the percentage of the earnings that is distributed could be recognized. On the facts described above, such a rule would mean that at the end of year two, when Euro Sub distributes 20% of its earnings and profits, $6.66 of the gain realized on the CFC Hedge (*i.e.*, 20% of the total gain realized on the CFC hedge) would be recognized. The difficulty with this approach is that in the case of a net investment hedge with respect to a CFC, there may not be a strong connection between the amount of earnings distributed and the hedged exposure.[56] Accordingly, such a rule may result in somewhat arbitrary timing of items on the CFC Hedge.

A third possibility would be to defer recognition of items of gain or loss on the CFC Hedge until such items are recognized in the applicable income statement for GAAP purposes. Unlike the situations described above in connection with Section 987 QBUs, Treasury's adoption of this approach in the context of net investment hedges of CFC shares is not dependent on the path Treasury chooses to go down with respect to section 987 more generally. On the facts described above, such a rule would mean that all of the gain that was realized on the CFC Hedge at the end of year two would be deferred until there was a realization event with respect to Euro Sub for GAAP purposes. This rule would be relatively simple to apply and administer and would not entail significant taxpayer electivity. It would also be most consistent with the corporate rationale for undertaking the transaction. While the rule could potentially result in timing mismatches (*e.g.*, if Euro Sub was terminated in an internal restructuring transaction that did not result in recognition for GAAP purposes), we expect that such mismatches generally would be preferable to the volatility in subpart F income/GILTI that could arise in the absence of any matching rule.

A fourth possibility would be to simply allow ordinary timing rules to control the recognition of items on the CFC Hedge. On the facts described above, such a rule would mean that gain (or loss) would be recognized on the CFC Hedge at the end of each of year one and year two under section 1256, which requires such positions to be marked to market at year-end. While this rule would be relatively simple to apply and administer, it would likely result in significant mismatches and volatility in subpart F income/GILTI over time (*i.e.*, as CFC Hedges mature and are rolled over).

H. Expansion of the Business Needs Exclusion for Disregarded Transactions

The third question relates to the consequences of disregarded transactions. In particular, the Preamble asks whether additional amendments to the business needs exclusion are

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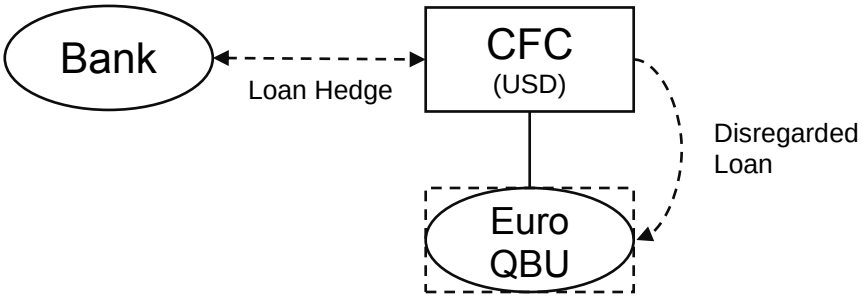
and proposing solutions). The authors suggest an alternative approach under which the hedge would be permitted to be identified solely for purposes of sections 263(g) 1092, 1256 and Treasury regulations section 1.954-2(a)(4)(ii) and the Reportable transaction rules. The same article, adopting the theme of coordinating tax hedging with financial accounting requirements, recommends members of an affiliated group (without the application of section 1504(b)), to hedge other members' risk. *See* page 267 (Problem 12)

[56] By comparison, in the case of a QBU Hedge, even if there is complexity associated with matching items on a QBU Hedge with the recognition of section 987 gain or loss upon a remittance, there can be a relatively strong connection between section 987 gain or loss and the hedged exposure.

appropriate to account for foreign currency gain or loss arising from a transaction that is entered into for the purpose of managing the foreign currency function with respect to disregarded transactions. Specifically, comments are requested regarding how the foreign currency gain or loss on such a hedging transaction "could or should be" allocated between subpart F and non-subpart F income and when such foreign currency gain or loss should be recognized.

Example 3:

Assume CFC makes a euro-denominated loan ("**Disregarded Loan**") to its Euro QBU with a principal amount of €100 at a time when the USD to euro exchange rate is $1 to €1. The loan has a five-year term and calls for annual payments of interest. At the time CFC makes the loan, it enters into the hedging transaction ("**Loan Hedge**") consisting of a forward contract to sell €100 for $100 at the end of a five-year period, and at the end of year five, the USD euro exchange rate is $1 to €0.5. Accordingly, at the end of the five-year period, the CFC will have realized a cumulative loss of $100 on the Loan Hedge. Finally, assume that at the end of year five, Euro QBU repays the principal amount of the €100 loan to the CFC, immediately prior to which, under the 1991 Proposed Regulations, and with respect to Euro QBU, the CFC has a basis pool equal to $200 and an equity pool equal to €200, triggering $100 of section 987 gain under the 1991 Proposed Regulations.[57] It has a corresponding economic gain on the Disregarded Loan of $100.



We believe that the business needs exclusion can and should potentially apply to hedges of disregarded transactions, such as the Disregarded Loan. Hedges of such transactions are not uncommon, and we believe they can be appropriately viewed as akin to net investment hedges, although they may not be treated as such for financial accounting purposes and therefore may not fall within the scope of the proposed exception for financial statement hedging transactions.[58] We understand that, historically, taxpayers taken the position that such hedges can be identified as hedges of the underlying disregarded transaction for financial reporting

[57] At the end of year five, immediately before the remittance, Euro QBU has unrealized section 987 gain equal to $200 (*i.e.*, €200 x $1/€0.5 - $200). The remittance triggers recognition of section 987 gain equal to $100 (*i.e.*, $200 x €100/€200).

[58] *See* 2013 Report, pages 69-71 (discussing hedges of disregarded loans); L.G. "Chip" Harter et al, *Financing International Operations*, 37 Int'l Tax J. 11, 16-17 (Sept. – Oct. 2011) (same).

purposes and identified as hedges of ordinary assets of the QBU or anticipated revenues for purposes of the business needs exclusion. There is potentially some tension, however, between the requirement that such transactions be entered into "primarily" to manage risk with respect to ordinary property (or other specified property) and the fact that such transactions may, in practice, be entered into principally to hedge the relevant disregarded transaction for financial reporting purposes. We note that in the insurance area, the Large Business and International Division ("**LB&I**") has accepted this divergence in identification (LB&I Directive-04-0514-0050(July 17, 2014).[59]

Consistent with this view, we believe it would be appropriate to clarify that the definition of a bona fide hedging transaction in Treasury regulations section 1.954-2(a)(4)(ii) includes a transaction entered into primarily to manage risk with respect to a disregarded transaction entered into with a QBU owned by the applicable CFC—in that case, although the hedging transaction may be entered into for financial reporting purposes, it has the effect of hedging assets or flows of the QBU—and it is evident that the transaction is entered into for non-speculative reasons. It may also be desirable to allow taxpayers to reasonably identify the underlying assets of the QBU that the hedge is intended to relate to for tax purposes. In addition, it may be worthwhile to establish a default rule in the absence of an affirmative identification of underlying assets (or if the identification is ambiguous or, for example, if the identification is in the alternative). For example, a hedge of a disregarded transaction that is not identified for tax purposes as hedging any specific assets of the applicable QBU could be treated by default as hedging a pro rata share of the assets of the applicable QBU. In either case, allocation of gain or loss on the Loan Hedge between subpart F and non-subpart F income should be determined based on the characterization of the assets or income flows to which the Loan Hedge relates.

Assuming the Loan Hedge is included within the scope of the business needs exclusion, there is a question regarding when items on the Loan Hedge should be recognized. Since the Disregarded Loan does not exist for tax purposes, the gain is recognized for GAAP purposes but is not recognized for tax purposes. One possibility would be to match the timing of the items of the Loan Hedge with the associated remittance (*i.e.*, the remittance that arises when the loan is repaid). On the facts described above such a rule could require that $100 of loss would be recognized with respect to the Loan Hedge at the end of year five when the Disregarded Loan is repaid. Such a rule would be consistent with the form of the Loan Hedge but may not result in a matching of the timing of items of the Loan Hedge with items on the economically hedged item. Where the Loan Hedge can be associated with particular assets of the QBU, a better match could potentially be achieved by treating the Loan Hedge as a hedge of those particular assets, in which case items of the Loan Hedge could potentially be matched to items recognized on those particular assets under Treasury regulations section 1.446-4. The same would follow if the Loan Hedge were treated as a hedge of anticipated cash flows.

[59] Here, LB&I accepted as valid hedges, positions held to fund reserve requirements related to equity based variable annuities. One could argue that the hedges were hedges of a capital asset (the equity) since the hedges were also designed to reduce risk with respect to the underlying equity position.

I. Expansion of Hedging Exception

The Proposed Regulations expand the hedge timing rules of Treasury regulation section 1.446-4 to include bona fide hedging transactions, but do not expand the definition of a hedging transaction in Treasury regulation section 1.1221-2(b) to cover all bona fide hedging transactions. The hedging exception to the straddle rules in section 1092(e) (which references the hedge exception in section 1256(e)) requires that the transaction meet the definition of a hedging transaction in section 1221(b)(2)(A). As a result, the Proposed Regulations create uncertainty as to whether the straddle loss deferral rule could still apply to a bona fide hedging transaction that falls outside the section 1221 definition of a hedging transaction, *e.g.*, hedges of the foreign currency risk on the acquisition of or disposition of a section 1231 asset, and hedges of the foreign currency risk with respect to a loan the taxpayer made to a foreign subsidiary. These transactions are common business hedges undertaken in the normal course of a U.S. taxpayer's business. Although the section 1231 asset or the loan receivable may not be ordinary property in the taxpayer's hands, the taxpayer is hedging the foreign currency risk with respect to the anticipated receipt (and disposition) of foreign currency, which qualifies as ordinary property.[60] In order to clarify that the hedge timing rules take precedence over the straddle rules for bona fide hedging transactions, we recommend that Treasury and the IRS expand the definition of a hedging transaction in Treasury regulation section 1.1221-2(b) to conform to the definition of a bona fide hedging transaction. This expanded definition ensures that these common foreign currency hedges qualify as section 1221 tax hedges, resulting in the desired matching of the character and timing of the hedge to the hedged item.[61] In the event that Treasury regulations section 1.1221-2(b) is not broadened to include all categories of transactions that constitute bona fide hedging transaction for purposes of the business needs exception, we recommend that the straddle rules not apply to defer currency loss with respect to positions that constitute bona fide hedging transactions described in Treasury regulations section 1.954-2(a)(4)(ii).[62]

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[60] Treasury regulations section 1.1221-2(c)(2) defines "ordinary property" as property that can never give rise to capital gain or loss if sold or exchanged. The disposition of foreign currency is a section 988 transaction that only gives rise to ordinary gain or loss. Section 988(c)(1)(C).

[61] Where the taxpayer is hedging the foreign currency risk on the sale of a section 1231 asset, there is the potential for a character mismatch as the gain on the disposition of the section 1231 asset is capital, while the loss on the foreign currency hedge may be ordinary. However, this character mismatch may be an acceptable side-effect given the benefits of conforming the definition of a section 1221 hedging transaction to the definition of a bona fide hedging transaction.

[62] As noted previously, in the case of a controlled foreign corporation, to avoid subpart F characterization, identification and recordkeeping requirements must be met. Under the passive foreign investment company ("**PFIC**") rules, passive income includes income of a kind which would be foreign personal holding company income as defined in section 954(c). Section 1297(b)(1). Literally, in the case of a PFIC, the same identification requirements must be met, but a U.S. person often has no mechanism to ensure that these requirements be complied with. We recommend that the identification and recordkeeping requirements for bona fide hedges of foreign currency gain or loss not be applicable in the case of PFICs. The same concern arises in the case of commodity transactions.

J. Modification of the Reportable Transaction Rules

Under Treasury regulations section 1.6011-4, certain categories of transactions are considered "Reportable transactions", reporting is required for corporations or taxpayers claiming losses of $10 million in a single year or $20 million in any combination of years, but in the case of foreign currency losses, reporting is required for individuals and trusts where there is a foreign currency loss is $50,000 or greater.[63] Rev. Proc. 2004-66[64] creates an exception from the reporting rules for transactions that are subject to mark-to-market treatment under section 475(a) or 475(f) or that are properly identified hedges under section 1221(b)(2).

Consistent with the other exceptions contained in Rev. Proc. 2004-66, we recommend that the Reportable transaction rules be modified to exclude transactions that are covered by an election under proposed Treasury regulations section 1.988-7.[65]

K. Issues Raised Under the Act

Assuming the transactions fit within the regime for a bona fide hedging regime and thus do not generate FPHCI, the transactions would seem to fall into the GILTI regime. While avoiding subpart F treatment has historically been the goal of tax planning this area, it is no longer as certain under the GILTI regime due to the foreign tax credit limitations. In high tax jurisdictions, some taxpayers may find subpart F treatment more favorable. In addition, the GILTI regime has significantly increased the importance of the timing of offsetting items that may be excluded from subpart F treatment.

Given the significant changes brought about by the Act, it is reasonable to consider what (if any) impact the new legislation should have on the above-described recommendations. In particular, it is reasonable to consider whether there should be a 'business needs' exclusion for the GILTI regime introduced by the Act. We do not recommend adding a business needs exclusion to the GILTI regime for two reasons. First, the policy rationale of subpart F and GILTI are very different. The subpart F regime specifically targeted certain types of income and is applied to CFCs on a stand-alone basis. The GILTI regime applies to the amount of income (of whatever type) generated by all related CFCs. Second, the problems that the Proposed Regulations seek to resolve by, for example, expanding the application of subpart F's business needs exclusion, do not exist to the same degree in the GILTI regime. Specifically, if a currency loss on a hedge and a gain on an underlying transaction are not realized by the same CFC, in the same year, and in the exact same category of FPHCI, the taxpayer can easily be whipsawed. The gain is taxed as subpart F income while its losses generally cannot be used to offset subpart income that is in a different category of FPHCI. In contrast, currency gains and losses would presumably offset other tested income in computing "tested income" for GILTI purposes, regardless of whether they are generated by the same CFC if earned in the same year. Even if

[63] Treas. Reg. § 1. 6011-4(b)(5)(i)(E).

[64] 2004-50 I.R.B. 966.

[65] *See* McDonald et al, *supra* note 55, at pages 265 to 266, suggesting a broadening of the hedging exception contained in Rev. Proc. 2004-66.

gains and losses were recognized in different years, the loss could still be used to reduce "tested income." Thus, the problems that the Proposed Regulations attempt to address with respect to subpart F income are not present under the GILTI regime.