



**Financial Services
Commission**

Administrative Notice No. 4

Consolidated Supervision

Date of Paper : 22 May 1995

Version Number : V1.00

File Location : document2

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Published by:

Financial Services Commission
PO Box 940, Suite 943, Europort, Gibraltar
Tel (+350) 40283
Fax (+350) 40282
E-Mail: info@fsc.gi
www.fsc.gi

Notice To Institutions Licensed Under The Banking Ordinance 1992.

1. This Notice, which takes immediate effect, applies to all licensees under the Banking Ordinance 1992 which are incorporated in Gibraltar. It implements the Council directive on the Supervision of Credit Institutions on a Consolidated Basis (92/30/EEC), which replaces the Council directive of 13 June 1983 (83/350/EEC).

Introduction

2. The Commissioner of Banking is committed to the principle that the supervision of licensees should be conducted on a consolidated basis, whenever such institutions are members of a wider group.
3. "Consolidation" is used in this Notice to mean the preparation of consolidated returns covering a group, or part of a group. The term "consolidated supervision" is used to mean a qualitative assessment of the overall strength of a group to which a licensee belongs, to evaluate the potential impact of other group companies on the licensee. This assessment will be based on a number of sources of information, one of which will be the consolidated returns. Consolidated supervision also takes into account the activities of group companies which are not included in the consolidated returns because the nature of their assets is such that their inclusion would not be meaningful, for example industrial or insurance companies. The Commissioner expects to have regular discussions with those members of the group's management who are familiar with, and have responsibility for, the overall group position. He also normally expects all group companies to have common auditors and the same financial years and accounting dates. If this is not the case, he will need to be persuaded that there are good reasons and that this will not hinder effective supervision.
4. The Commissioner will take account of the activities of group companies to the extent that they may have a material bearing on the reputation and financial soundness of the licensee in the group. It must be emphasised that the focus of the Commissioner's supervision remains the licensee itself. The purpose of consolidated supervision is not to supervise all the companies in a group to which a bank belongs, but to supervise the bank as part of its group.
5. The Commissioner regards consolidated supervision as a complement to, rather than a substitute for, the solo supervision of the licensee. Events elsewhere in the group and the activities of other group companies can pose a threat to the licensee in ways which consolidated supervision cannot detect. For example, intra-group linkages arising from transactions between the bank and other group companies will only be revealed by the solo supervision of the bank. Hence the Commissioner will continue to monitor solo capital adequacy ratios and set large exposures limits for licensees in addition to those which may apply at the consolidated level.

Capital Adequacy and Large Exposures

6. The Commissioner will require licensees affected by these requirements to submit, at least twice each year, consolidated returns covering capital adequacy and large exposures.
7. To assess capital adequacy on a consolidated basis, the Commissioner will apply the Own Funds Directive and the Solvency Ratio Directive, as implemented by the relevant Administrative Notices. Licensees will be set a consolidated risk assets ratio, in addition to that set on a solo basis.

8. The measurement on a consolidated basis of the concentration of risk and large exposures to individual borrowers or closely related borrowers will be based on the Large Exposures Directive (see Administrative Notice No3).
9. In accordance with article 3.6 of the Consolidated Supervision Directive, the Commissioner will also require licensees to have adequate internal control mechanisms for the production of any data and information which would be relevant for the purposes of supervision on a consolidated basis.

Scope of Consolidation

10. The Commissioner regards the principles laid down in the Consolidated Supervision Directive as minimum standards, and he will extend his consolidated supervision beyond the requirements of the directive where he judges that to do so results in a more accurate assessment of risk to the licensee.
11. The Commissioner will require consolidation in the following cases:
 - (i) When the licensee is itself the parent of companies which conduct one or more of the activities listed on the Annex to this Notice; and
 - (ii) When the licensee is not the parent company, but is part of a group or sub-group whose business wholly or mainly comprises the activities listed in the Annex to this Notice, and the parent of which is itself a financial institution. To qualify as a financial institution the exclusive or main business of the parent company must be either to carry out one or more of the activities listed in the Annex, or to acquire holdings in companies undertaking these activities.
12. The Commissioner will interpret the phrases "mainly" and "main business" to mean the balance of business, i.e. he will generally require consolidation when companies carrying out the listed activities comprise the majority (over 50%) of the group or sub-group balance sheet. In determining the balance of business the Commissioner will additionally take account of the off-balance sheet activities of group companies, and of fee-based services provided by group companies. Where such a balance of business test proves inconclusive, the Commissioner will take into consideration the number of subsidiaries which fall into the financial and non-financial categories. As a general rule, the presumption will be in favour of consolidation.
13. Where consolidation of a group is required it will extend to all financial companies in the group, including the parent company itself, subsidiaries of the parent company, and companies in which the parent company or its subsidiaries have a participation of 20% or more of the voting rights or capital ("participations"). Companies whose business is not covered by the list of activities contained in the Annex will not usually be included in consolidation; however, the Commissioner may, at his discretion, require their inclusion. When the Commissioner agrees that a company is to be excluded from consolidation, the investment of the parent in that company will be deducted from the licensee's consolidated capital for assessment of capital adequacy.
14. In certain cases a licensee will already be subject to the consolidated supervision of another EU supervisor. The Commissioner may, at his discretion, agree to forgo consolidation in that case, following discussion with the other supervisor. In those instances in which a licensee is a member of a group with banks in a number of other EU Member States, the Commissioner will generally take the view that responsibility for consolidated supervision should fall with the EU



supervisor within whose jurisdiction the principal bank in the group is incorporated.

15. Consolidation of a group whose parent company is incorporated in a country which is not a member of the EU will not normally be required; in determining the appropriate treatment in these cases the Commissioner will take into account whether or not the parent company is subject to the consolidated supervision of another supervisor which adheres to the Basle minimum standards for the supervision of international banking groups and their cross-border establishments. However, in those cases in which the Commissioner determines that a group consolidation would not be appropriate, if the licensee has any subsidiaries, sub-consolidation will nonetheless usually be required.

Definition of Subsidiary and Participation

16. The definition of parent and subsidiary which should be applied in the preparation of consolidated returns to the Commissioner is that contained in the seventh company law directive (83/349/EEC). In addition, the threshold for the consolidation of group companies which are not subsidiaries - "participations" - is the ownership of 20% or more of the voting rights or capital.
17. Consolidation will also normally be required of companies over which the parent or another group company exercises "dominant influence". In determining whether or not dominant influence exists the Commissioner will generally make use of the definition provided by the contemporary UK accounting standards.

Techniques of Consolidation

18. The technique of consolidation which will usually be required will be full consolidation for all majority shareholdings, and normally of participations. The Commissioner will apply proportionate ("pro rata") consolidation to participations in only exceptional circumstances, where he is satisfied that there are other significant shareholders who have the means and the will to provide as much parental support to the entity as the shareholder subject to consolidated supervision. This criterion is usually most likely to be met by another bank.

Exceptions to Consolidation

19. In a limited number of cases the Commissioner may permit the exclusion from a group's consolidated returns of subsidiaries and participations which otherwise meet the criteria for consolidation, as provided for by article 3.3 of the Consolidated Supervision Directive:
 - (i) Where inclusion would be inappropriate or misleading;
 - (ii) Where institutions within the overall group to be consolidated have a combined balance sheet total of less than ECU 10 million or 1% of the balance sheet total of the parent (the "de minimis" exemption);
 - (iii) Where there are legal impediments to the transfer of information. Use of this reason for exclusion other than on a temporary basis is likely to be inconsistent with the Basle Minimum Standards and the Commissioner will not normally make use of this provision.

The Commissioner's prior consent must be sought for all proposals to exclude subsidiaries or participations from consolidation.

Distribution of Capital Resources Within the Group

20. The Commissioner will normally apply the same capital ratio to the group as a whole as he applies to the principal bank in the group, i.e. a solvency ratio of at least 10%. Factors which are taken into account in setting a consolidated ratio which differs from that set for the principal bank on a solo basis include: the location of capital in the group, in particular to ensure that reliance is not being placed on surplus capital which is locked in to particular companies or countries because of regulatory considerations, exchange controls, or taxation; the degree of risk diversification in the group as a whole compared to that of the bank or banks within it; and any risks which arise on a group basis but which are not reflected in the factors influencing the ratio appropriate for the principal bank in the group.
21. Since consolidated supervision does not replace supervision on a solo basis, but is complementary to it, licensees which are members of groups subject to the Commissioner's consolidated supervision will be expected to maintain minimum capital ratios in line with those expected of entirely independent banks undertaking the same range and scale of business. However, licensees which meet the criteria set out in paragraph 22 will normally be set a capital ratio which is the same as the capital ratio set for the consolidated group, unless there are particular circumstances which warrant a different ratio.

Concessionary Weighting of Intra-group Exposures

22. To minimise double counting of capital requirements, exposures to another group company may be nil-weighted for the calculation of the reporting institution's solo capital ratio in circumstances agreed by the Commissioner to meet the following criteria:
- (i) the group is managed as an integrated banking business by a Gibraltar bank, which is the principal bank in the group; and
 - (ii) the other group company is consolidated for the purposes of calculating the group's consolidated capital ratio; and
 - (iii) capital resources are freely transferable between the other group company and the principal bank in the group.

Solo Consolidation

23. In calculating a licensee's solo ratio the Commissioner is prepared to consider the consolidation of certain subsidiaries, specifically where all the following conditions apply:
- (i) the subsidiary is at least 75% owned by the reporting institution;
 - (ii) either the subsidiary is wholly funded by its parent bank or all of its exposure to risk is wholly in respect of its parent bank;
 - (iii) the management is under the effective direction of the parent bank;
 - (iv) it is clear that there are no potential obstacles to the payment of surplus capital up to the parent bank, in particular taking account of overseas exchange controls, potential legal and regulatory problems and taxation; and



- (v) there is sufficient capital in the bank's own balance sheet to fund its investments in those subsidiaries which are to be solo consolidated (i.e. if the investments were to be deducted rather than solo consolidated, the parent should be left with positive net worth).

Groups not subject to Consolidation

- 24. In those cases in which a licensee belongs to a group for which the Commissioner determines consolidation would be inappropriate (for example in cases where the preponderance of the group's business comprises industrial or insurance business), the Commissioner will require the parent institution and its other subsidiaries to supply him with any data or information which he considers relevant to the purpose of supervising the licensee. The Commissioner may also, from time to time, seek to have the information which is supplied to him verified by the licensee's auditors.
- 25. When the parent of a licensee is an insurance company the Commissioner will not normally require consolidation, pending further harmonisation of the basis of accounting for banks and insurance companies.



Annex : Financial Activities To Be Consolidated:

1. Ancillary Banking Services (defined as: "an undertaking the principal activity of which consists in owning and managing property, managing data processing services, or any other similar activity which is ancillary to the principal activity of one or more credit institutions".)
2. Lending (including, inter alia, consumer credit, mortgage credit, factoring with or without recourse, financing of commercial transactions (including forfaiting)).
3. Financial leasing.
4. Money transmission services.
5. Issuing and administering means of payment (e.g. credit cards, travellers' cheques and bankers' drafts).
6. Guarantees and commitments.
7. Trading for own account or account of customers in:
 - (a) money market instruments (cheques, bills, CDs etc);
 - (b) foreign exchange;
 - (c) financial futures and options;
 - (d) exchange and interest rate instruments;
 - (e) transferable securities.
8. Participation in securities issues and the provision of services relating to such issues.
9. Advice to undertakings on capital structure, industrial strategy and related questions and advice and services relating to mergers and the purchase of undertakings.
10. Money broking.
11. Portfolio management and advice.
12. Safekeeping and administration of securities.

NOTE : Companies undertaking one or more of these activities are classified as "financial" for the purpose of this Notice.