



**Financial Services  
Commission**

# **Administrative Notice No. 8**

## **The Post BCCI Directive: Close Links**

Date of Paper : 19 August 1998

Version Number : V1.00

File Location : document5



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## Section I: Introduction

- 1 This Notice is issued by the Commissioner of Banking under section 16(2) of the Banking Ordinance 1992 (the "Ordinance") to facilitate compliance in Gibraltar with relevant Community obligations. The so-called "Post-BCCI" Directive (95/26/EC) (the "Directive") was implemented in Gibraltar in respect of credit institutions with effect from 5<sup>th</sup> January 1998 by the Banking (Auditors & Information) Ordinance 1997 and the Financial Institutions (Prudential Supervision) Ordinance 1997 (the "Prudential Supervision Ordinance").
- 2 One of the four main provisions of the Directive, that relating to "close links", introduces a new obligation for the relevant credit institutions and the Commissioner of Banking. It applies to both Gibraltar incorporated credit institutions and non-EEA incorporated credit institutions licensed under the Ordinance. In order for Gibraltar to comply with this provision, the Banking Supervisor will require some additional information from credit institutions. The information requirement is not set out explicitly in the Prudential Supervision Ordinance and this Notice explains what is now required. Detailed requirements with respect to Gibraltar incorporated institutions are set out in Sections II and III below. The definition of "close links" is set out in Section IV and in detail in the Prudential Supervision Ordinance.
- 3 In summary, the "close links" provision obliges the Commissioner of Banking to refuse applications for licences, and gives him the power to cancel licences, where the existence of a close link between a credit institution and another undertaking or individual prevents the effective exercise of his or the Banking Supervisor's supervisory functions in relation to the institution. This includes situations where the laws of a non-member State (or difficulties relating to their enforcement) governing a closely linked entity are such as to prevent effective supervision of the credit institution. Credit institutions are, in turn, obliged to provide the Banking Supervisor with the necessary information relating to their close links.
- 4 Many of the relationships covered by the "close links" definition will already be reported to the Banking Supervisor as a result of consolidated supervision or under the existing shareholder controller reporting arrangements and the information should therefore be easily accessible; but the close links of subsidiaries and the links between fellow subsidiaries will now also be covered formally.
- 5 For Gibraltar incorporated credit institutions, information is required on all close links, subject to the list of exclusions set out in Section II of this Notice. For example, these exclusions will normally cover any closely linked entity that represents less than 5% of group regulatory capital and group revenues and group profits - in order to exclude those entities which are not likely to be of material significance to the group. However, the Banking Supervisor reserves the right to seek information on closely linked entities which fall within this list of exclusions where he judges this to be necessary. The details of the initial and ongoing information requirements are set out in Sections II and III below. Requirements for non-EEA incorporated credit institutions will be notified on an individual basis (see paragraph 11).
- 6 ***The definitions provided in Section IV of this Notice are intended to be helpful and not to provide a complete summary of either the Directive or the Prudential Supervision Ordinance - they should not be regarded as a substitute for referring to the legislation itself.***



## Section II: Notification Requirements

- 7 The Banking Supervisor requires Gibraltar incorporated credit institutions licensed under the Ordinance to notify him of all the entities with which they have "close links" with the exception of the following:
- (a) a close link with any entity which represents less than 5% of:
    - (i) group regulatory capital and
    - (ii) group revenues within a given 12 month period and
    - (iii) group pre-tax profits, or losses, over a given 12-month period.
  - (b) close links with any entity to which the licensed credit institution has an exposure of less than 10% of its solo (or solo-consolidated) large exposures capital base.
  - (c) close links with dormant companies.
  - (d) close links arising from shareholdings held by investment management companies operating on behalf of third parties.
- 8 Those entities with which a credit institution has close links and that are not covered by any of the above exemptions must be notified to the Banking Supervisor. It should also be emphasised that if any one of the figures quoted in paragraph 7 (a)(i), or (a) (ii), or (a) (iii), or (b) above is exceeded at any time, the link must be notified to the Banking Supervisor.
- 9 Close links with non-trading holding companies and with individuals (as opposed to legal undertakings) should also be reported, irrespective of the exemptions listed above. As regards individuals, much of the relevant information may already be provided to the Banking Supervisor under the Ordinance but should nevertheless be provided for the purposes of reporting a close link, if appropriate.
- 10 The Banking Supervisor reserves the right to seek information on other close links covered by these exemptions where he judges this to be necessary. In certain cases, the Banking Supervisor may also want to obtain further information on particular close links. There may also be situations in which a reporting institution itself judges that an entity with which it has close links, and which falls within the exemptions above (and would therefore not normally need to be notified), is significant for some other reason and the Banking Supervisor expects to be informed of any such cases should they arise.
- 11 The Banking Supervisor will discuss individually his requirements for notification of close links in respect of non-EEA incorporated credit institutions licensed under the Ordinance and the procedures to be followed. He will take into account the materiality of those links and arrangements for supervising them in the home country but would, in any case, expect to be informed of significant changes in a banking group structure which might affect the non-EEA incorporated credit institution. As in the case of Gibraltar incorporated credit institutions, there may be situations in which the reporting institution itself judges that an entity with which it has close links, and which falls outside the reporting requirements the Banking Supervisor has specified with respect to the reporting institution, is significant for some other reason. The Banking Supervisor expects to be informed of any such cases should they arise.
- 12 The Banking Supervisor may periodically include the monitoring of close links for both Gibraltar incorporated credit institutions and non-EEA incorporated credit institutions within the scope of section 60 reports. Institutions should also



be aware that a failure to notify close links may be considered an offence under section 82 of the Ordinance.

### Section III: Notification Procedure

- 13 The Banking Supervisor will discuss individually his requirements for notification of close links with non-EEA incorporated credit institutions. Gibraltar incorporated credit institutions are required to provide the following:
- (a) A submission listing all those entities or individuals with which they have "close links" either in the form of a list or a group organogram **within three months of the date of this Notice**. This should include:-
    - (i) for corporates, the nature of the close link (e.g. for participations the level of participation); the country of incorporation; and the registered number; and
    - (ii) for individuals, the nature of the close link: and the date and place of birth.
  - (b) This list or organogram should be updated annually, together with the annual return of controllers submitted under section 36(3) of the Ordinance.
  - (c) The Banking Supervisor expects to be informed in advance, but in any event no later than 30 days after, of any changes to an institution's close links submission which occur before the annual update is due. Relevant changes include new close links; the termination of a close link; and changes in status of existing close links, including changes in the level of "participation".
  - (d) Where closely linked entities are not reported, on the basis that they are covered by one of the exclusions in Section II above, but the reporting institution expects that within the next year they are likely to become a notifiable close link, they should also be reported, separately.

### Section IV: Definition Of Close Links

- 14 This section explains the definition of "close links" set out in the Prudential Supervision Ordinance. It should be stressed that the definitions below apply only for the purpose of the close links notification requirement arising from the Post-BCCI Directive; they do not apply in any other context and do not affect, for example, the Ordinance's definitions of parent and subsidiary undertaking. The concept of "close links" applies both to individuals and to corporate undertakings. These definitions apply both to notification requirements for Gibraltar incorporated credit institutions as set out in this Notice, as well as to notification requirements for non-EEA incorporated credit institutions which will be notified individually.
- 15 The Directive differentiates between two types of "close link": "control" relationships, which are effectively parent/subsidiary relationships, and "participation" relationships, where there is a permanent participating interest (shareholding) of 20% or more of the voting or non-voting share capital. The Prudential Supervision Ordinance, however, incorporates the concept of a participating interest by defining it as a further category of parent/subsidiary relationship.
- 16 The Prudential Supervision Ordinance defines an undertaking as "closely linked" with:



- (a) any person who is or, if he were an undertaking, would be its **parent undertaking**;
- (b) any undertaking which is its **subsidiary undertaking**;
- (c) any undertaking which is or, if any person falling within paragraph (a) were an undertaking, would be a **fellow subsidiary undertaking**; and
- (d) any person in accordance with whose directions or instructions its directors are accustomed to act.

**"Fellow subsidiary undertakings"** are undertakings which are subsidiary undertakings (unless defined by 18(g) below) of the same parent undertaking but are not parent undertakings or subsidiary undertakings of each other.

## "Parent Undertakings" and "Subsidiary Undertakings"

- 17 The definitions of parent undertaking and subsidiary undertaking in the Prudential Supervision Ordinance are based on Article 1 of the Seventh Company Law Directive (7CLD). For the purposes of defining "close links" in the context of the Directive, however, all the 7CLD definitions of parent/subsidiary undertakings are relevant. These definitions [(a) – (e) below] each constitute what is referred to in the Directive itself as "control" relationships. The Prudential Supervision Ordinance also adds the further definitions [(f) and (g) below] which reflect the reference in the Directive to "participation" relationships.
- 18 Hence, for the purposes of establishing whether or not a "close link" applies, an entity is considered to be a **parent undertaking** in relation to another undertaking ("a **subsidiary undertaking**") if -
- (a) it holds a majority of the voting rights in the undertaking; or
  - (b) it is a **member of the undertaking** and has a right to appoint or remove a majority of its board of directors; or
  - (c) it has the right to exercise a dominant influence over the undertaking -
    - (i) by virtue of provisions contained in the undertaking's memorandum or articles, or
    - (ii) by virtue of a control contract; or
  - (d) it is a **member of the undertaking** and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in the undertaking; or
  - (e) it is a **member of the undertaking**, no other person is the undertaking's parent by virtue of any of paragraphs (a) to (c), and, at all times since the beginning of the undertaking's immediately preceding financial year, a majority of the undertaking's board of directors have been directors who were appointed solely as a result of the exercise of its voting rights; or
  - (f) it has a **participating interest** in the undertaking and either actually exercises a dominant influence over the undertaking or it and the undertaking are managed on a unified basis; or
  - (g) it has a **participating interest** in the undertaking which either entitles it to 20% or more of the voting rights in the undertaking or comprises 20% or more of the shares in the undertaking.



An undertaking is treated as a ***member of another undertaking*** -

- (i) if any of its subsidiary undertakings is a member of that other undertaking; or
- (ii) if any shares in that other undertaking are held by a person acting on behalf of the undertaking or any of its subsidiary undertakings.

A ***parent undertaking*** is treated as the parent undertaking of undertakings in relation to which any of its subsidiary undertakings (unless defined by (g) above) are, or are to be treated as, parent undertakings.

A "***participating interest***" (see (f) and (g) above) is an interest in shares held by an undertaking in another undertaking which it holds on a long term basis for the purpose of securing a contribution to its activities by the exercise of control or influence arising from or related to that interest. The reference to the purpose and activities of an undertaking includes the purposes and activities of any of its subsidiary undertakings and of the group as a whole. An interest in shares includes -

- an interest which is convertible into an interest in shares; and
- an option to acquire shares or any such interest; and
- an interest held on behalf of an undertaking; and
- an interest held by any of its subsidiary undertakings.

(A holding of 20% or more of the shares of an undertaking will be presumed to be a "***participating interest***" unless the contrary is shown.)

- 19 As regards a "participation" [(f) and (g) above], the relationship must be "permanent" for a "close link" to exist. The Directive states that a "temporary investment, which does not make it possible for the holder to exercise influence over the structure or financial policy of the undertaking" does not constitute "participation". Hence, it does not constitute a close link. The Banking Supervisor, therefore, takes the view that, for example, market-makers' holdings and holdings in the trading book will not normally fall within the definition of a close link, as they are considered to be "temporary".

## Chains of Ownership

- 20 In the case of a chain of ownership the question of whether or not a close link exists involves the distinction between a "control" relationship [definitions (a) - (e) in paragraph 18 above] and a "participation" relationship [definitions (f) and (g) in paragraph 18 above]. Three examples are given below, and are illustrated by Figures 1-5.

A parent undertaking (X), which has a "participation" relationship only with another undertaking (Y), will not be treated as a parent undertaking of another undertaking (Z) solely because Y has a "control" or "participation" relationship with Z. Hence, X and Y would be closely linked, as would Y and Z; but X and Z would not be closely linked (see Figure 1).



But, if using the same example, parent undertaking X had a "control" relationship with Y, and Y as a parent undertaking had either a "control" or a "participation" relationship with Z, then X would also be a parent undertaking of Z. Hence all three undertakings would be closely linked to one another (see Figure 2).

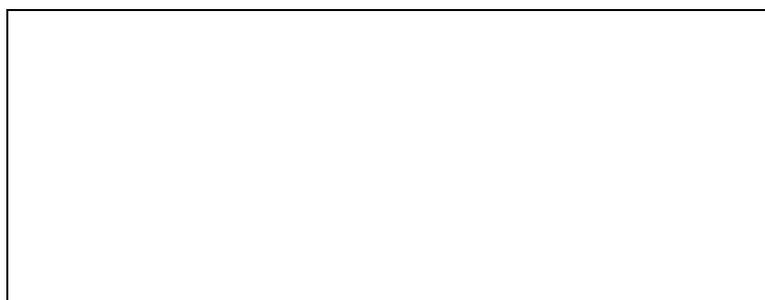
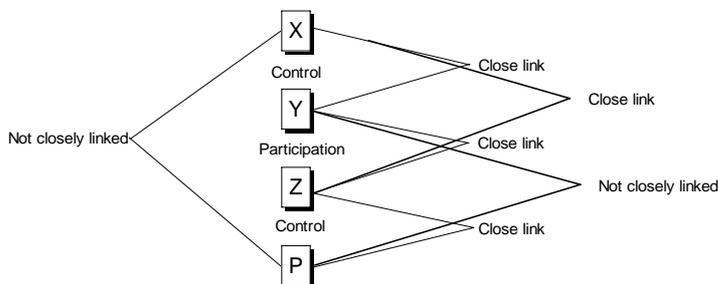
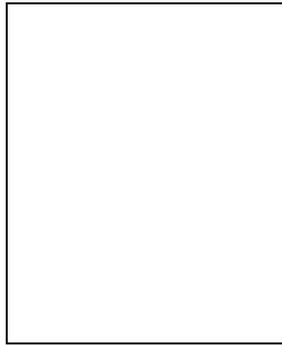


Figure 3 sets out the position in situations where the chain of ownership is extended further.



### "Fellow Subsidiaries"

- 21 A situation in which two or more undertakings are permanently linked to one and the same entity by a "control" relationship is also regarded as constituting a close link between them. For example, separate subsidiaries of the same parent would be regarded as having close links between them if the parent/subsidiary relationships were both "control" relationships. Separate parents of the same subsidiary would also be regarded as closely linked.
- 22 However, two subsidiaries of the same parent are not "fellow subsidiary undertakings" if the parent has only a "participation" relationship with one or both undertakings (see Figure 4).



But, if, using the same example, both undertakings were linked to the parent undertaking by "control" relationships then they would be "fellow subsidiaries" and would be closely linked to one another (see Figure 5).

