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“... consolidated capital resources of a group must exceed its consolidated capital resources requirement”

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CONSOLIDATED SUPERVISION

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Overview

Consolidated supervision is not a new topic for FSA regulated firms. However, the new rules introduced within BIPRU as of 1 January 2008 potentially mean that a wider number of firms will be subject to consolidated supervision. The purpose of consolidated supervision is to help regulators supervise groups that contain regulated entities by requiring them to calculate, and provide details of, the consolidated financial position for their group in addition to the position of the regulated entity when considered on a solo basis. A group that falls within consolidated supervision, and so reports on a consolidated basis, must ensure that the consolidated capital resources of the group are equal to or exceed its consolidated capital resources requirement.

Background

The intention of consolidated supervision is to highlight whether problems exist in any single entities within the group as this could impact on the overall financial strength of the group. This might include the way in which individual group companies are capitalised, instances of double counting or the occurrence of financial difficulties within an unregulated entity within the group. Any of the above could have repercussions for the group as a whole. It is possible that some of these problems might not be detected if consolidated supervision was not applied.

The FSA Rules

The rules for consolidated supervision can be found in Chapter 8 of BIPRU. These rules replace those contained within IPRU (INV) (Chapter 14) for BIPRU firms. However, it is important to note that the rules in Chapter 14 have not been switched off entirely and still impact on some non-BIPRU firms, for example commodities firms subject to the exemption in Article 48(2) of the CRD (as amended by the Capital Adequacy Directive). The rules in BIPRU 8 identify the scope of a group and explain the prudential requirements that apply to it. They also set out the calculation of group capital resources and group financial resource requirements as well as the basis for excluding undertakings from a group for consolidation purposes.

Groups

Groups can be determined by the following:

- ownership (eg a parent might have >50% of the voting rights of a subsidiary);
- participation (eg a parent might have >20% of the voting rights of another entity);
- joint management (eg two entities that are jointly managed, possibly pursuant to provisions in their memorandum or articles of association);
- significant influence (eg one entity is able to exert a significant influence over another without necessarily holding capital in it).

“... a firm may be in a UK consolidation group and also a non-EEA sub group”

“... exemptions and waivers are available in certain circumstances”

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UK consolidation groups and non-EEA sub groups

There is a distinction between these two types of group, and the FSA must be provided with separate consolidated returns in respect of each type. An individual firm must first identify whether it belongs to a UK consolidation group and then identify any other group entity that belongs to the same group to determine the scope of the UK consolidation group. It must then repeat the exercise, but in relation to any non-EEA sub group that might exist. This can be tricky, but the basic steps are as follows.

To identify a UK consolidation group:

- establish whether a UK consolidation group exists using the decision tree set out in BIPRU 8 Annex 1 (decision tree identifying a UK consolidation group);
- identify the firm (the trigger firm) in the group structure;
- work up the group structure to the highest relevant UK bank/financial parent;
- work back down the structure and capture all relevant firms worldwide.

To identify a non-EEA sub group it is necessary to identify each undertaking in the UK consolidation group that satisfies the following:

- it is an institution, financial institution or asset management company whose head office is outside the EEA; **and**
- it is a subsidiary undertaking of a BIPRU firm in the UK consolidation group or a BIPRU firm in that UK consolidation group holds a participation in it; **and**, crucially,
- that BIPRU firm is not a parent institution in a Member State.

Consolidated capital calculations

There are three consolidation methods, namely:

- Method 1 - the aggregation method: under this method, a firm must apply the risk capital requirement to each undertaking in the UK consolidation group or non-EEA sub-group and add them together;
- Method 2 - the accounting consolidation method: under this method, a firm must treat the whole UK consolidation group or non-EEA sub-group as a single undertaking and apply the risk capital requirement to the group on an accounting consolidation basis;
- Method 3 - a mixture of methods 1 and 2: under this method a firm may treat one or more parts of the group as separate single undertakings. It must apply the risk capital requirement to each such part of the group on an accounting consolidation basis and apply the risk capital requirement to each of the remaining undertakings in the group. It must then add the risk capital requirements together.

Exemptions and opportunities arising out of Consolidated Supervision

BIPRU contains a number of exemptions from consolidated supervision as well as waivers which firms may be able to take advantage of. These are often quite complex and there will usually be a number of conditions that apply.

Summary

All BIPRU firms should review their group structure to establish whether they are subject to consolidated supervision and if they are ensure they fully understand the extent of consolidated capital resources calculations and consolidated reporting.

Please let your usual Bovill contact know if you need any assistance with consolidation.