Guidelines for Consolidated Accounting and Consolidated Supervision

Ref DBS.FID No. C-5 / 01.02.00/2002-03

August 1, 2003

The CEOs of the all-India term lending and refinancing institutions

Dear Sir,

Guidelines for Consolidated Accounting and Consolidated Supervision

Please refer to our Circular DBS.FID No. C-7 / 01.02.00/2002-03 dated September 2, 2002 forwarding the draft guidelines for Consolidated Accounting and Consolidated Supervision of the FIs. In the light of the comments received, and the views expressed at the meeting held with the select FIs on December 20, 2002, we have reviewed the guidelines and the final guidelines are enclosed. The guidelines should be implemented with effect from the year **commencing from April 1, 2003** (July 1, 2003 in case of National Housing Bank - NHB).

2. The supervisory framework for consolidated supervision of the FIs comprises the following three components:

(a) consolidated financial statements (CFS);

(b) consolidated prudential returns (CPR); and

(c) application of prudential regulations like capital adequacy, large exposures and liquidity gaps on group-wide basis.

2.1 The CFS are public documents to be prepared and published **annually,** in addition to the solo annual reports of the FIs and their subsidiaries published separately at present, and submitted **to RBI within one month** of the publication of its annual accounts. While the publication of the CFS as per the Accounting Standard (AS) 21 of the Institute of Chartered Accountants of India (ICAI) has already become mandatory for the listed FIs in terms of the Listing Agreement, the guidelines seek to make such publication mandatory even by the non-listed FIs, from the financial year commencing from April 1, 2003 onwards.

2.2 The CPR are a set of two off-site returns viz., CPR-1 and CPR-2, to be submitted to RBI, initially at **half-yearly** intervals, for the period ending September 30, 2003 onwards. The CPR may be submitted by the FIs to the Financial Institutions Division except in case of the FIs which have **a bank in the group** - in which case the CPR may be sent to the Chief General Manager, OSMOS Division, Department of Banking Supervision, Central Office, Reserve Bank of India, Centre I, World Trade Centre, Colaba, Cuffe Parade, Mumbai - 400 005. The **first set of CPR** for the half-year ending September 30, 2003 (December 31, 2003 in case of NHB) may be submitted to the RBI at the earliest but **not later than December 31, 2003 (March 2004 in case of NHB)**. The CPR for the subsequent periods should be submitted **within 90 days** of the close of the half-year to which the CPR relates.

2.3 As a part of implementation of consolidated supervision, it has also been decided to prescribe the **group-wide prudential norms** for capital adequacy and large exposures for the FIs. The FIs should ensure compliance with these norms, on an ongoing basis from the **year commencing from April 1, 2003** (July 1, 2003 in case of NHB), taking into account the assets and liabilities of their subsidiaries / associates also, in addition to compliance by the FIs

/subsidiaries / associates with the prudential norms that may be applicable to them, on *solo* basis. The prudential norms for group-wide capital adequacy, large exposure and the liquidity mismatches would be as indicated below and would apply **in addition to** the solo prudential norms applicable to the parent FIs/ subsidiaries.

2.3.1 Capital adequacy

The FIs should maintain, **on a group-wide basis**, a minimum Capital to Risk-weighted Assets Ratio (CRAR) of **nine per cent** on an ongoing basis from the **year commencing from April 1, 2003** (July 1, 2003 in case of NHB). The group-wide regulatory capital for the purpose of CPR should be determined keeping in view the guidelines detailed at para 4.2 of **Appendix - B**.

2.3.2 Large Exposures

As a prudential measure aimed at better risk management and avoidance of concentration of credit risks, in addition to prudential limits on exposure of the *solo* entities, the FIs at the **group-wide level** should also adhere to the following prudential limits, on an ongoing basis from the year beginning April 1, 2003 (July 1, 2003 in case of NHB):

Single borrower exposures at the group level	15% of capital funds of the Group
	Upto 20% of capital funds of the Group provided the additional exposure of up to five percentage points is for the purpose of financing infrastructure projects
Group borrower exposures at the group level	40% of capital funds of the Group
	Upto 50% of capital funds of the Group provided the additional exposure of up to 10 percentage points is for the purpose of financing infrastructure projects

The 'capital funds' of the Group for the purpose of exposure norms would be the same as reckoned for the purpose of group-wide capital adequacy. The measurement of credit exposure at the group level should be done in the same manner as prescribed for the FIs on a solo basis.

2.3.3 Liquidity mismatch

With effect from the year beginning April 1, 2003 (July 1, 2003 in case of NHB) the prudential limits for negative liquidity mismatches **at the group level** in the first two time bands of 1-14 days and 15-28 days, would be at **10% and 15% of the aggregate group-wide cash outflows in these time buckets**. The compilation of the group-wide liquidity gap report should be done as per the extant ALM Guidelines applicable to the FIs on *solo* basis. However, the intra-group transactions and exposures should be excluded from this consolidation. The monitoring of the liquidity gaps should, therefore, be ensured at the group-wide level also, in addition to the monitoring for the parent FI at the solo level.

3. The guidelines for the consolidated supervisory framework, as applicable to the select all-India financial institutions, are furnished in the **Annexure** and the guidelines for compilation of CFS and CPR are furnished at **Appendix A** and **Appendix B,** respectively.

4. It is clarified that the requirement of **transfer of 20 per cent of net profits** to Reserve Fund [in terms of Section 45-IC(1) of the RBI Act] in respect of the FIs which are structured as companies, would continue to be in relation to the solo profit of the parent FI and of each of the NBFCs, if any, within the group, and not with reference to the consolidated net profit of the group.

5. This Circular may please be placed before the Board of Directors of your institution at its ensuing meeting and appropriate steps taken for implementation.

6. Please acknowledge receipt.

Yours faithfully,

(S. S. Gangopadhyay)
Chief General Manager

ANNEXURE

Guidelines for Consolidated Supervision of
the select all-India Financial Institutions

The consolidated supervision of financial intermediaries has acquired special significance in the Indian context due to the emergence of complex group structures. In such structures, a supervised entity might belong to a Group headed by a holding / parent entity which in turn might also have several other subsidiaries and affiliates – some of which might not even be subject to a formal regulation / supervision. The primary objective of consolidated supervision is to evaluate the strength of an entire Group taking into account all the risks (including those arising from the operations of related entities) that may affect the **supervised entity** in the Group – regardless of whether these risks are carried in the books of the supervised entity or the entities related to it. It needs being emphasised that the purpose of consolidated supervision is **not** to supervise each and every entity within a group but to supervise the regulated entity **as a part of the Group**, so as to take into account the likely risks that may arise from various parts of the Group for the supervised entity. Failure of large and established international banks in the past on account of the operations of their subsidiaries illustrates the magnitude of such risks, which has heightened the supervisory concerns.

2. In this background, the RBI had set up a multi-disciplinary "**Working Group on Consolidated Accounting and Other Quantitative Methods to Facilitate Consolidated Supervision**" under the Chairmanship of Shri Vipin Malik, formerly Director, Central Board of RBI in November 2000 for examining the feasibility of introducing consolidated accounting and other quantitative methods to facilitate consolidated supervision and to make recommendations accordingly. The Working Group, which had detailed deliberations with the representatives of select FIs as well, submitted its report in December 2001 – which can be accessed at the RBI web site www.rbi.org.in. The recommendations of the Working Group were examined in the RBI and it has been decided to implement them with appropriate modifications, wherever considered necessary, in respect of the select all-India financial institutions also. The following guidelines have accordingly been formulated for effecting consolidated supervision of the FIs.

3. **Definitions:**

3.1 For the purpose of these guidelines, the terms '**parent**', '**subsidiary**' and '**group**' would have the same meaning as ascribed to them in the Accounting Standard 21 (AS-21) of the Institute of the Chartered Accountants of India (ICAI).

3.2 The term '**associate**' would have the same meaning as ascribed to it in the AS-23 of the ICAI.

3.3 For the purpose of compiling the CPR, which requires consolidation of subsidiaries and associates engaged only in 'financial activities', the activities listed *illustratively* in **Appendix B-3** would be deemed to be the '**financial activities"**.

4. Scope

For the present, consolidated supervision would be implemented for all the groups where the parent (i.e., the holding / controlling entity) is an institution which falls within the regulatory / supervisory domain of the RBI. Accordingly, these guidelines would be applicable to the nine FIs which, at present, are regulated and supervised by this Division as all-India financial institution, viz., IDBI, IFCI Limited, TFCI Limited, IIBI Limited, IDFC Limited, EXIM Bank, NHB, NABARD and SIDBI.

5. Elements of consolidated supervision

The consolidated supervision as implemented by the RBI, includes the following elements:

a) Consolidated Financial Statements **[CFS]**, which are intended for public disclosure for market discipline.

b) Consolidated Prudential Returns **[CPR]** for supervisory assessment of risks which may be transmitted to the FIs (or other supervised entities) by other group members.

c) Application of certain prudential regulations like capital adequacy, large exposures, etc. on group-wide basis.

The guidelines for compilation of CFS and CPR, as also the reporting format of the CPR, are furnished at **Appendix A** and **Appendix B,** respectively.

APPENDIX - A

Guidance Note for Preparation of Consolidated Financial Statements (CFS)

The CFS should be prepared primarily in terms of the AS-21 of the ICAI keeping in view the following aspects:

1.1 COMPONENTS: CFS should normally include consolidated balance sheet, consolidated statement of profit and loss, Notes on Accounts, other statements and explanatory material that form an integral part thereof.

1.2 EFFECTIVE DATE: All the FIs falling within the purview of solo supervision of RBI, whether listed or unlisted, should prepare and publish CFS with effect from the financial year

commencing from April 1, 2003 (July 1, 2003 in case of National Housing Bank), **in addition to** the solo financial statements, published at present.

1.3 EXTENT OF CONSOLIDATION: A parent, presenting the CFS, should consolidate the financial statements of **all subsidiaries** – domestic as well as foreign, except those specifically permitted to be excluded under the AS-21 the ICAI. The reasons for not consolidating a subsidiary should be disclosed in the CFS. The responsibility of determining whether a particular entity should be included or not for consolidation would be that of the Management of the parent entity. In case, its Statutory Auditors are of the opinion that an entity, which ought to have been consolidated, has been omitted, they should incorporate their comments in this regard in the "Notes to Account".

1.4 COMPLIANCE WITH ACCOUNTING STANDARDS: CFS should be prepared in terms of AS -21 and other related Accounting Standards prescribed by the ICAI, viz., AS-23 relating to 'Accounting for Investments in Associates in Consolidated Financial Statements' and AS-27 relating to 'Financial Reporting of Interest in Joint Ventures'.

1.5 FORMAT OF CFS: Since AS-21 does not prescribe a format for publishing consolidated financial statements, FIs should publish their CFS in the format of their respective **solo financial statements**. As stated above, the CFS would be in addition to the FIs' and their subsidiaries' solo annual accounts prepared as per the formats prescribed under their respective statutes.

1.6 REFERENCE DATE FOR CONSOLIDATION: The financial statements used for the purpose of consolidation should be drawn up to the same reporting date. When the reporting dates are different, the subsidiary often prepares, for consolidation purposes, statement as at the same date as that of the parent. When it is impracticable to do this, AS-21 permits use of financial statements drawn upto different reporting dates provided the difference in reporting dates is not more than six months and prescribes that adjustments should be made for the effects of significant transactions or other events that have occurred during the intervening period. Where the reference dates of the accounts of the parent and its subsidiaries coincide, the FIs which are subject to the audit by the Comptroller and Auditor General of India (CAG) may publish their CFS without waiting for the audit of the subsidiaries by the CAG, but only after the statutory audit of the subsidiaries has been completed.

1.7 ACCOUNTING POLICIES:

1.7.1 CFS should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. (For the purpose, the FIs may rely on a Statement of Adjustments for non-uniform accounting policies furnished by the statutory auditors of the subsidiaries.) If it is not practicable to do so, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.

1.7.2 If different entities in a group are governed by different accounting norms laid down by the respective regulator for different businesses then, in cases where "term lending" or "refinancing" is the dominant activity of the group, accounting norms applicable to the parent FI should be used for consolidation purposes in respect of like transactions and other events in similar circumstances. In situations where no accounting norms have been prescribed by the regulatory authority of the subsidiary, and different accounting policies are followed by different entities of the group, '**balance of business**' **test** may be applied for deciding the applicable accounting norms. The 'balance of business' test would imply that a line of business

or activity accounting for **more than 50 per cent of the aggregate group assets** would be deemed to be the 'dominant activity' of the group, and the accounting policies / norms applicable to that 'dominant activity' would apply to the subsidiary for which no accounting norms have been prescribed by the sectoral regulator. For dissimilar items and circumstances, different accounting policies would have to be followed.

1.8 ACCOUNTING FOR INVESTMENTS:

1.8.1 The investments in **associates** (other than those specifically excluded under AS-23) and **subsidiaries** should be accounted for under the "Equity Method" of accounting in accordance with As-23.

1.8.2 The valuation of investments in **associates** (which are excluded under AS 23) and **unconsolidated subsidiaries** should be done as per the investment valuation norms of RBI, as applicable to the FIs.

1.8.3 The investments in **joint ventures** should be accounted for under the 'proportionate consolidation' method as per Accounting Standard 27 on "Financial Reporting of Interests in Joint ventures" issued by ICAI.

1.9 DISCLOSURES: The disclosures in the CFS under "Notes to Accounts" should be normally confined to the extent required by the RBI for the parent FI on a solo basis supplemented by the information already available in the solo statements of the subsidiaries. No fresh / additional information need be sought from the subsidiaries for the purposes of disclosures. However, the FIs may be guided by the **general clarifications** issued by the ICAI in this regard.

APPENDIX - B

Guidance Note for Preparation of Consolidated Prudential Returns (CPR)

1. AN OVERVIEW

1.1 The FIs falling within the scope of consolidated supervision of RBI should, in addition to the CFS, also prepare CPR, in the formats attached at **Appendices B-1** and **B-2**, for submission to RBI, as part of the off-site reporting system. The objective of the Consolidated Prudential Return (CPR) is to collect consolidated prudential information **at the level of the group** to which the supervised institution belongs. It aims to capture data, in the prescribed format, mainly on the following aspects:

a. Consolidated Balance Sheet ;
b. Consolidated Profit & Loss Account;
c. Select data on financial/ risk profile of the group; and
d. Operations of subsidiaries / related entities

To begin with, only two **half-yearly** CPR are being prescribed - **CPR 1** and **CPR 2**, to be submitted to RBI as at the end of March and September (June and December in case of NHB), **within 90 days** of the end of the relative half-year. While the first three aspects ('a' to 'c' above) would be captured in CPR 1, the operations of the subsidiaries / related entities are to be reported in CPR 2. The CPR 2 is, however, to be submitted in respect of each subsidiary / related entity, separately. The reporting frequency would be reviewed and modified, if

necessary, in due course. The CPR would be **in addition to** the Consolidated Financial Statements (referred to at Appendix A) and the existing off-site returns compiled and submitted to RBI on solo basis by the FIs. In the CPR 1, apart from the consolidated balance sheet and the profit and loss account, four prudential parameters viz., **capital adequacy, large exposures, forex exposures and liquidity mismatches** are also required to be reported, on a **group-wide basis**, for three of which **group-wide prudential norms** have been prescribed, as detailed in the following paragraphs. The first set of CPR should be submitted for the half-year ended **September 30, 2003** (December 31, 2003 in case of NHB) not later than December 31, 2003 (March 31, 2004 in case of NHB).

1.2 In preparation of CPR, the data to the extent applicable, may be derived from the consolidated balance sheet and profit and loss account, prepared as per guidelines in Appendix A, also taking into account the instructions contained in the formats of the CPR and the consolidated prudential norms now prescribed at Para 4 of this Appendix.

2. **DEFINITIONS:** For the purpose of CPR, the following definition would apply:

2.1 Subsidiary: It is an entity that is 'controlled' by another entity known as 'parent'.

2.2 Parent: It is an enterprise that has one or more subsidiaries.

2.3 Control: It is defined as:

a) the ownership, directly or indirectly through subsidiary(ies), of more than one-half of the voting power of an enterprise; or

b) control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from its activities.

2.4 Related entities: The term 'related entity' would include all such 'subsidiaries' and 'associates', which are, controlled by the same shareholders as the FI itself.
(For the purpose of compiling CPR, the test applied for identifying related entities is '**common control**' and not only the size of the ownership stake or shareholding in the controlled entity. For consolidation in the supervisory context, the "related entity / common control approach" replaces the 'subsidiary approach' of AS 21.)

2.5 Associate: The term 'associate' would have the same meaning as ascribed to it in the AS-23. However, an '**associate**' of an FI would **normally** be an entity in which the FI holds more than 20% but less than 50% of the paid up equity capital or voting rights in respect of that entity, directly or indirectly, as on the date of the FI's last published balance sheet.

3. **SCOPE OF CONSOLIDATION AND REPORTING**

3.1 The FIs within the supervisory domain of RBI, which are a parent / holding entity within the group, should submit CPR encompassing the information and assets and liabilities of all those "**related entities"** under their control which are engaged in "**financial activities**". An **illustrative list** of 'financial activities' is furnished at **Appendix B-3**. For the purpose of preparation of CPR, the **general** principles / guidelines prescribed in various Accounting Standards of the ICAI [viz., AS 21 (Consolidated Financial Statements), AS-23 (Accounting for Investments in Associates in Consolidated Financial Statements) and AS-27 (Financial

Reporting of Interests in Joint Ventures)] may be used. However, the consolidation for CPR should be confined to only those 'related entities' which are engaged in "**financial activities**" (Cf. Appendix B-3) and should **exclude** group companies, which are engaged in:

(a) insurance business (regardless of their status in the group - as parent or as related entity), and

(b) businesses **not** pertaining to financial services.

In case of any doubt as to whether the financials of a particular entity need to be consolidated in the CPR, the FIs should consult RBI regarding the scope of consolidation.

3.2 The FIs should justify the exclusion or inclusion of any entity for the purpose of CPR in Section A of the CPR 1. The valuation of investments in related entities, which are not consolidated in the CPR (e.g., insurance and non-financial entities), should be done as per the investment valuation norms of RBI.

4. Application of Group-wide Prudential Norms on consolidated position

4.1 For the purpose of application of prudential norms on a group-wide basis, a 'group' is defined as a group of entities (which might also include a licensed bank) engaged in financial activities, with the FI as the parent. As a part of consolidated supervision, the prudential norms/ limits, as detailed below, in the following areas have been prescribed for compliance, on a **group-wide / consolidated** basis:

a) Capital Adequacy
b) Large Exposures
c) Liquidity mismatches

4.2 Capital adequacy

4.2.1 The FIs should maintain, on a group-wide basis, an ongoing minimum Capital to Risk-weighted Assets Ratio (CRAR) of nine per cent from the year commencing **from April 1, 2003** (July 1, 2003 in case of NHB).

4.2.2 The assessment of group-wide capital adequacy on a consolidated basis becomes necessary to obviate the phenomenon of double / multiple gearing of capital within a group - that is, deployment of the same capital of the parent in several other legal entities/ subsidiaries ('down-streaming' of capital). Some of the examples of "double-gearing" are furnished at **Appendix B-4**. This could lead to situations where each entity in a group might be in compliance with the solo regulatory capital prescription but at the group-level / on consolidated basis there could be a capital deficit. Thus, assessment of group capital merely on the basis of solo capital requirements of the constituents could overstate the external capital of the group. Hence, assessment of group capital should exclude intra-group holdings of regulatory capital.

4.2.3 The group-wide CRAR, for the purpose of CPR, should be determined keeping in view the following guidelines:

(i) Where the solo regulatory capital norms for the related entities, are more stringent than those for the parent FI, such norms should be treated as the regulatory minimum for such entities. The regulatory capital and the risk-weighted assets of such entities as

defined by the sectoral regulator should be reckoned in computation of the group-wide CRAR.

(ii) Where, however, the capital adequacy norms for the related entities at the solo level are non-existent or less stringent than the norms for the FIs, the norms applicable to the parent FI should be applied to the related entities, as a proxy for solo norms, for computing the capital adequacy ratio at the consolidated level. Accordingly, the same risk weights and credit conversion factors, as applicable to the parent FI, on a solo basis, under the extant capital adequacy norms, should be notionally applied to the assets and the off-balance sheet items of the related entities of the FI.

(iii) The group-wide risk-weighted assets (RWAs) should be arrived at by adding the RWAs of the parent FI with that of the related entities as computed in the manner indicated at (i) and (ii) above;

(iv) In respect of the entities at item (ii) above, the various components of capital/ liabilities of the subsidiaries should be examined with reference to the same criteria as applicable to the parent FI, on a solo basis, under the extant capital adequacy norms, for determining their eligibility for inclusion in the group-wide regulatory capital. The regulatory capital of the entities at item (i) above and the eligible components in the capital of the parent FI and the related entities should be added for determining the group-wide Tier 1 and Tier 2 capital;

(v) From the group-wide regulatory capital arrived at, as per (iv) above, the following deduction should be made, in equal proportion from the consolidated Tier 1 and Tier 2 capital of the group:

- the parent FIs' investments in insurance subsidiaries (as consolidation of insurance subsidiaries in the CPR is not mandated);

- accumulated losses and intangible assets, if any, of the parent FI as also of the subsidiaries;

- the shortfall, if any, in the regulatory capital, as prescribed by the solo regulators, of the **subsidiaries** engaged in 'financial activities', ,

  (so as to address the risk of the parent FI being called upon to meet such capital shortfall);
- shortfall, if any, in the regulatory capital in the **unconsolidated entities** (i.e., the entities which are not consolidated in the CPR but are engaged in the 'financial activities'). The amount of shortfall to be deducted from group capital should be proportionate to the parent's/group's equity stake in such unconsolidated entity(ies).

- investments of the parent FI in entities engaged in 'financial activities', exceeding 20 per cent but less than 50 per cent of its **own** paid up equity capital (as such investments are considered significant); and

- Significant minority and majority investments by the FIs **in commercial entities**, which exceed certain materiality level. The materiality level should be reckoned as 15 per cent and 60 per cent of the FI's equity capital

for 'individual significant investment' and aggregate of such significant investments, respectively.

(The investment in commercial entities would, however, not include the securities acquired by the FIs in the borrower companies as part of the project financing operations or through conversion of debt).

(vi) The group-wide CRAR should be computed with reference to the amounts arrived at steps (iii) and (v) above.

However, for the purpose of, computing group-wide CRAR, *pro rata* share of the parent FI in the regulatory capital of its **subsidiaries** which is in excess of the subsidiary's own regulatory capital requirements, and which could be regarded as, in principle, available to support risk in the parent or in other entities in the group, should a shortfall arise, **can be recognised** in the group-wide capital adequacy assessment.

(vii) Capital for market risk: In computation of consolidated group capital, the capital charge for market risk, prescribed for the FIs, should also be taken into account. In case of unregulated entities in the group or where the sectoral supervisor has not prescribed any capital charge for market risk for a related entity, the norms for capital charge for market risk as applicable to the FI should be used as proxy for such related entities.

4.3 Large Exposures

4.3.1 As a prudential measure aimed at better risk management and avoidance of concentration of credit risks, in addition to prudential limits on exposures of solo entities, the FIs at the **group-wide level** should also adhere to the following prudential limits:

Single borrower exposures at the group level	15% of capital funds of the Group Upto 20% of capital funds of the Group provided the additional exposure of up to five percentage points is for the purpose of financing infrastructure projects
Group borrower exposures at the group level	40% of capital funds of the Group; Upto 50% of capital funds of the Group provided the additional exposure of up to 10 percentage points is for the purpose of financing infrastructure projects

4.3.2 The 'capital funds' of the Group for the purpose of exposure norms would be the same as reckoned for the purpose of group-wide capital adequacy. The measurement of credit exposure at the group level should be done in the same manner as prescribed under the extant exposure norms for the FIs, on a solo basis. The individual exposures (funded as well as non-funded) of the entities in the group to the same counterparty should be consolidated for determining the group-wide exposure levels. However, the exposures of only those entities in the group should be consolidated which are covered within the scope of consolidation for CPR, as detailed at para 3 above.

4.4 Liquidity mismatch

4.4.1 Maturity wise distribution/ analysis of assets and liabilities should be reported, on a consolidated basis in the format prescribed in CPR -1, Section D, in order to reflect the

liquidity risk faced by the group. Separate currency-wise reports are required for the rupee and foreign currency denominated assets an liabilities. The prudential limits for negative liquidity mismatches **at the group level** in the first two time bands of 1-14 days and 15-28 days, would be at **10% and 15%, respectively, of the aggregate group cash outflows in the respective time buckets**, as also applicable to the FIs on solo basis under the extant ALM Guidelines. Intra-group transactions and exposures should be excluded from this consolidation.

4.4.2 This liquidity report may be prepared by placing all cash inflows and outflows of all the entities in the group, which are covered within the scope of consolidation for CPR purposes, as detailed at para 3 above, in the maturity ladder according to the expected timing of the cash flows, following the guidelines prescribed vide Circular DBS.FID. No. C-11/01.02.00/1999-2000 dated 31 December 1999, as amended from time to time.

4.4.3 The format suggested for the liquidity report is in vogue for the FIs at present and the reporting institutions may consolidate the liquidity gap report by putting together the transactions, which are of the similar nature, following the format.

Confidential

APPENDIX - B-1

Consolidated Prudential Return (CPR) 1 **WORD** **PDF**

Confidential

APPENDIX - B-2

Consolidated Prudential Return (CPR) 2

(To be submitted every half-year, **separately for each subsidiary / related entity**)

Report on Operations of Subsidiaries / Related Entities (ROS)

Reporting Institution :

For the Period Ended : **31 March / 30 September 20XX**

Date of Report :

Subsidiary/entity Code : **Subsidiary/entity name** :……………………

Activity Name :

Regulator's Name :

Validation Status :

Part A - Operational Parameters (Rs. in lakhs)

Balance Sheet Footings (Total Assets) :

Capital Funds*	
Minimum Capital Prescribed by Regulators (if any)	
Minimum Capital Adequacy Prescribed by Regulators (%)	
Capital Adequacy Ratio (Actual) (%)	
Notional Capital Funds**	
Notional Risk-Weighted Assets**	

Notional Capital Adequacy Ratio** (%)	
Capital & Reserves	
Total Deposit	
Total Borrowings	
Profit after Tax/Return	
Surplus/(Loss) on Profit & Loss a/c carried forward	
Return on Assets	
Return on Equity	
Loans and Advances - Gross	
Non-performing Loans - Gross	
Provisions held against Non-performing loans	
Provisions required against Non-performing loans Investments	
Total Investments - Book Value	
Total Investments - Market Value	
Non-performing Investments	
Provisions held against Non-performing Investments	
Provisions required against Non-performing Investments	
Contingent Liabilities	

* As defined by the entity's regulators ** Calculated as per note 3.5 below.

Part B - Large Exposures and Ownership Details

Large Credits (Substantial Exposures exceeding 10 % of Capital Funds)	
No. of Counterparties	
Aggregate Exposure (Amount)	
Aggregate Exposure (% of Capital funds)	
Ownership Summary	
Investment in Capital by Parent Bank (Amount)	
% of Shares held by Parent Bank	
% of Total Capital held by Parent Bank (including Tie II Capital)	

NOTES:

1. This return had been introduced with the objective of collecting information / data on Indian subsidiaries and related entities of the financial institutions and analyse their impact on the parent FI. In view of the emerging supervisory approach for conducting consolidated supervision, the scope of this return includes all subsidiaries and related entities in India. The reporting under the return would, thus, cover all subsidiaries and related entities in India which are engaged in 'financial activities'.

Focus of the Return

2. The return focuses on parameters relating to capital adequacy, asset quality, profitability, large credits and ownership and control of the Indian subsidiaries of the FIs. The return seeks to monitor compliance of the FIs with RBI regulations as well as compliance of subsidiaries with the regulations prescribed by their respective regulators particularly in respect of capital adequacy with a view to gauging the impact of subsidiaries' operations on the parent FI.

Operational Parameters

3.1 Capital Funds

Capital funds should be calculated as per the definition of the regulator responsible for regulation of subsidiary / related entity.

3.2 Minimum Capital Prescribed by Regulators

It refers to the Minimum capital, if any prescribed, for starting the company, by the regulator of the subsidiary.

3.3 Capital Adequacy Ratio

It refers to the minimum capital adequacy ratio prescribed by the regulator of the subsidiary.

3.4 Actual Capital Adequacy Ratio

The actual capital adequacy ratio calculated as per the methodology prescribed by the subsidiary's regulators may be furnished.

3.5 Notional Capital Funds, Notional Risk-Weighted Assets, Notional Capital Adequacy Ratio

For the purpose of determining the notional capital funds and notional RWAs of the subsidiaries / related entities, the instructions as detailed at para 4.2 of Appendix B of these guidelines should be followed and the notional CRAR of their subsidiaries / related entities should be worked out accordingly.

APPENDIX - B-3

An illustrative list of "Financial Activities"

Entities undertaking one or more of the following activities should be considered to be engaged in **"financial" activities**:

1. Ancillary Banking Services (defined as: "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 forfeiting)).

3. Financial leasing

4. Money transmission services

5. Issuing and administering means of payment (e.g. credit cards, travellers' cheques and banker's 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.

(Source: Bank of England Notice on the implementation of the Directive on the Consolidated Supervision of Credit Institutions (BSD/1993/1)

APPENDIX -B-4

Examples of Double / Multiple Gearing of Capital

Some of the examples of the situations of double / multiple gearing of capital that can be faced by the supervisors in assessment of group-wide capital adequacy of financial conglomerates are furnished below.

1. Double and multiple gearing

The parent is an insurance company, which has a 100% investment in a bank, which in turn has a 100% investment in a securities firm.

Insurance Company A1 (Parent)

Liabilities		Assets	
Capital	1,000	Investments	5,000
General reserves	500	Book value investments in Bank B1	500
Technical provisions	4,000		
Total	**5,500**	**Total**	**5,500**
		Solvency requirement	800

Bank B 1 (Subsidiary)

Liabilities		Assets	
Capital	500	Loans	8,750
General reserves	400	Book value investments in Securities B2	250
Other liabilities	8,100		
Total	**9,000**	**Total**	**9,000**
		Solvency requirement	800

Securities Firm B2 (Subsidiary)

Liabilities		Assets	
Capital	250	Investments	4,000
Reserves	250		
Other liabilities	3,500		

Total	**4,000**	**Total**	**4,000**
		Solvency requirement	**400**

Wilhout provisions to account for this corporate structure in measures *of* capital adequacy, it appears that solo capital requirements for the individual entities in this group are met. However, it is clear that a portion of the capital of the parent insurance company, i.e. the amount of 500 invested in bank B 1 is levered twice, once in the parent and again in bank B1 (double gearing). Furthermore, the amount invested by B1 in the securities firm B2 (250), which has already been levered twice, is now being levered a third time, in the securities firm (when capital is being levered more than twice, it is said to be an instance of multiple gearing).

On the face of it, the group has total capital and reserves of 2,900 to cover total solvency requirements of 2,000. If the multiple gearing is eliminated, the adjusted capital and reserves reduce to 2,150 leaving a surplus *of* only 50 over the capital requirements of 2,000. All three techniques should yield these results.

2. Undercapitalised unregulated holding company

An unregulated holding company with two regulated 100% subsidiaries and the unregulated 100% subsidiary. Both regulated entities meet their solo requirements.

Unregulated Holding Company A1

Liabilities		Assets	
Capital	300	Book-value investment in	
Other liabilities	800	Bank B 1	800
(long 'term loan)		Insurance company B2	200
		Leasing company B3	100
Total	**1,100**	**Total**	**1,100**

Bank B1 (Subsidiary)

Liabilities		Assets	
Capital	800	Loans	900
Other liabilities	500	Other assets	400
Total	**1,300**	**Total**	**1,300**

Insurance Company B2 (Subsidiary)

Liabilities		Assets	
Capital	200	Investments	7,000
General-reserves	100		
Technical provisions	6,700		
Total	**7,000**	**Total**	**7,000**

Unregulated Leasing Company B3 (Subsidiary)

Liabilities		Assets	
Capital	100	Leases	2, 000
Other liabilities	1,900		
Total	**2,000**	**Total**	**2,000**

Group (consolidated)

Liabilities		Assets	
Capital	300	Bank loans	900
General reserves	100	Other bank assets	400
Other bank liabilities	3,200	Insurance investments	7,000
Technical provisions	6,700	Leases	2,000
Total	**10,300**	**Total**	**10,300**

(i) Assume the solo capital requirements/solvency margins of the regulated companies are as follows:

	Requirement	Actual Capital	Surplus/(Deficit)
Bank B1	100	800	700
Insurance Company B2	300	300	0
"Notional" capital proxy } for the Leasing Company B3 }	150	100	(50)

(ii) Under the **building-block prudential approach**, the aggregated solo capital requirements and proxies (B1: 100; B2 : 300; B3 : proxy of 150: Total: 550) are to be compared with the consolidated capital (300 + 100 = 400). The group has a solvency deficit of 550 -400 = 150.

(iii) Under the **risk-based aggregation method**, the solo capital requirements and proxies are again aggregated (550); the total requirements are compared to the sum of the capital held by the parent and its subsidiaries, deducted from the amount of- the intra-group holding of capital [300 (parent) + 800 (B1) + 300 (B2) + 100 (B3) -1,100 (investments) = 400]. Again, the group has a solvency deficit of 150.

(iv) Under the **risk-based deduction method**, in the balance sheet of the parent the book value of each participation is replaced by its surplus or deficit value, i.e. total assets minus liabilities and minus capital requirement/proxy of the subsidiary. The book-values of B1 (800),B2 (200) and B3 (100) are replaced by the solo surplus/deficit identified under (i): B1 (700), B2 (0), B3 (-50).

The revised balance sheet of the parent holding company is then as follows:

Liabilities		**Assets** Investments in:	
Capital	-150	B1	700
Other liabilities	800	B2	0
		B3	-50
Total	**650**	**Total**	**650**

Again, the result of the calculation shows a group solvency deficit of 150.

(v) When there is an unregulated holding company, the total deduction method is not applicable.

(vi) Conclusions:

Although both regulated entities meet their own solo or sector solvency requirements, the financial conglomerate on a group-wide basis is under capitalised. The explanation is twofold: first, there is excessive leverage in the group, as the parent has downstreamed debt to its subsidiaries in the form of equity capital, and secondly there is an undercapitalised unregulated entity in the group.

The undercapitalisation of the group is a potential risk for both regulated entities. As shown in the example, the undercapitalisation can be revealed by applying appropriate measurement techniques for the assessment of capital adequacy at group level.

3. <u>Minority interests and double gearing</u>

This example shows that where minority interests are present the choice between full integration and pro-rata integration can have a material effect on the assessment of group capital adequacy.

A decision has to be made, explicitly or implicitly, as to how to deal with minority interests in the various entities of the group. Essentially, the question is whether to include them by using full integration or to exclude them by using a pro-rata approach.

The example, using the risk-based aggregation method, demonstrates that full consolidation may yield a less conservative result than the pro-rata approach in cases where there are important surpluses and no deficits at solo level elsewhere in the group and thus, may mislead supervisors about the situation of the group.

Consider first a regulated parent and its 100% participation in a regulated subsidiary .

Parent	
Capital	100
Capital requirements	-90
Participation 1 (historic cost)	40
SOLO SURPLUS	**10**
Subsidiary 1 (100%)	
Capital	40
Capital requirement	-25
SOLO SURPLUS	**15**
Group (Parent + Subsidiary 1)	
Capital	140
-parent	100
-subsidiary	40
Capital requirement	-115
-parent	-90
-subsidiary 1	-25
Participation (book value)	-40
GROUP DEFICIT	**-15**

Both institutions (parent and subsidiary 1) comply with their respective capital requirements at solo level. The assessment of capital adequacy at group level, however, reveals that there is an element of double gearing, which would call for regulatory action from the parent's regulator. As a result, the parent would have to increase its capital or to reduce its risk or the subsidiary's risk. (Since the parent has a 100% stake in the first subsidiary, there is no difference between full and pro-rata integration).

Consider a situation where the parent also has a 60% participation in a second subsidiary with a considerable surplus at solo level.

Subsidiary 2 (60 %)	
Capital	100
-parent	60
-minority interest	40
Capital requirements	-25
SOLO SURPLUS	**75**

The group position would be as follows:

Group (Parent + Subsidiary 1 + Subsidiary 2)

	Full Integration	Pro-rata integration
Capital	240	200
-parent	100	100
-subsidiary 1	40	40
-subsidiary 2	100 (60 parent's share; 40 minority interests)	60
Capital requirement	-140	-130
-parent	-90	-90
-subsidiary 1	-25	-25
-subsidiary 2	-25	-15
Participation 1(book value)	-40	-40
Participation 2 -60 (book value)	-60	
GROUP DEFICIT	**0**	**-30**

While pro-rata integration reveals a deficit at group level, full integration of the second subsidiary in the group calculation reveals no deficit because the second subsidiary's surplus compensates for the previous deficit at group level. This is because full integration regards capital elements attributable to minority shareholders as available to the group as a whole unless supervisors decide to limit the inclusion of the excess capital of this subsidiary. Of course, if the second subsidiary had a capital deficit at solo level then full integration would reveal a larger deficit at group level than pro-rata integration because full integration has the effect of placing full responsibility for making good the deficit on the controlling shareholder (the parent).

4. Inadequate distribution of capital

This example, which uses the risk-based aggregation method, illustrates, as did example 3, the implications of using a full-integration or a pro-rata approach. At the same time, it shows the application of a notional capital proxy to an undercapitalised unregulated entity whose business activities are similar to those of the regulated entities.

The existence of solo requirements should normally prevent deficits at solo level in firms of the group. In cases where one entity of the group has a solo deficit, supervisors should consider whether excess capital in other firms of the group can cover such 'solo deficit. In the following example this excess capital is needed to cover notional deficits in an unregulated entity:

Parent	
Capital	100
Capital requirement	75
Participation	25 (historic cost)
Subsidiary 1 (50% participation)	
Capital '	60
-equity .	50
-reserves	10
Capital requirement'	10
SOLO SURPLUS	50

Group

	Pro-rata aggregation	Full aggregation
Capital parent	100	100
Capital subsidiary	30 (50% of 60)	60
Capital requirement		
-parent	-75	-75
-subsidiary	-5 (50% of 10)	-10

Participation	-25(book value)	-25
GROUP SURPLUS	**25**	**50**

The surplus at group level stems exclusively from the partly-owned subsidiary. However, in the event that the parent also had a participation in an undercapitalised unregulated entity, t}1e group position would bc as follows:

Unregulated Subsidiary 2 (100% participation)	
Capital	20
-equity	10
-reserves	10
Notional capital requirement	-50
Notional solo deficit	**-30**

Group

	Pro rata aggregation	**Full aggregation**
Capital	150	180
-parent	100	100
-subsidiary 1	30(50% of 60)	60
-subsidiary 2	20(100% of 20)	20
Capital requirements	-130	-135
-parent	-75	-75
-subsidiary 1	-5	-10
-subsidiary 2	-50	-50
Participation 1	-25	-25
Participation 2	-10	-10
GROUP SURPLUS	**-15**	**10**

Under the full integration approach, the surplus in subsidiary 1 is regarded as available to the group as a whole and it thus more than compensates for the deficit in subsidiary 2. The pro-rata approach on the other hand, only takes account of that part of the surplus in subsidiary 1 which is attributable to the parent and, as shown, this is not sufficient to offset the deficit in subsidiary 2 and the parent would either have to reduce its own risks, to increase its own capital or to renounce to the acquisition of the second firm.