BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

PRA statement on the concept of 'durable link'

Purpose

This Prudential Regulation Authority (PRA) statement clarifies the PRA's interpretation of the concept of 'durable link', which is important for ascertaining whether a holding of less than 20% in another undertaking is to be treated as a 'participation' for the purposes of the Capital Requirements Regulation (575/2013) (CRR). This in turn determines the correct capital treatment of the investment in the hands of the firm. In accordance with the CRR, the PRA requires firms to proportionally consolidate participation interests in other undertakings while non-participatory significant investments must be deducted from regulatory capital, subject to specific thresholds.

Background

Article 4(1)(35) of the CRR defines a 'participation' as follows:

- *'participation' means participation within the meaning of the first sentence of Article 17 of Fourth Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies, or the ownership, direct or indirect, of 20 % or more of the voting rights or capital of an undertaking.*

Article 2(2) of the Directive 2013/34/EU, which replaced the Fourth Council Directive, states that:

- *'participating interest' means rights in the capital of other undertakings, whether or not represented by certificates, which, by creating a durable link with those undertakings, are intended to contribute to the activities of the undertaking which holds those rights. The holding of part of the capital of another undertaking is presumed to constitute a participating interest where it exceeds a percentage threshold fixed by the Member States which is lower than or equal to 20%.*

Durable link

The PRA's interpretation of durable link takes into account the definition of 'significant influence' under the accounting framework. While an accounting determination of significant influence is a key factor in determining whether there is a durable link, other factors regarding the financial, governance and management intent of the firm's management will also be considered as explained below.

Significant Influence

IAS 28 *Investments in Associates and Joint Ventures* defines significant influence as the power to participate in the financial and operating policy decisions of the investee but not to control those policies. The accounting test is whether an entity has the ability to exercise that power regardless of whether the significant influence is actively demonstrated or is passive in nature.

International Financial Reporting Standards stipulate that the factors below should be considered in deciding whether a firm has the power to participate in the financial and operating policy decisions of an undertaking:

a) representation on the board of directors or equivalent governing body of the investee;
b) participation in policy-making processes, including participation in decisions about dividends or other distributions;
c) material transactions between the entity and its investee;
d) interchange of managerial personnel; and
e) provision of essential technical information.

Other factors

The PRA, in addition to taking into account whether there is significant influence under the accounting framework, will also consider the future intentions of the firm's management in deciding whether a relationship arising pursuant to rights in the capital of the investee constitutes a durable link. The durable link assessment will take into account, on a forward-looking basis, the strategic importance of the stake to the firm. This would include, in particular, consideration as to:

- whether the firm's management intends to maintain or increase its financial stake in the undertaking;
- the role the firm's management intends to play in the undertaking's governance and management; and
- whether such arrangements are aligned with the firm's longer-term strategic ambitions.

The PRA also expects these arrangements to be communicated appropriately to all key stakeholders. This assessment could lead to a different conclusion to the accounting framework determination of significant influence in some circumstances.

Financial intent

The PRA will consider evidence of an intention by a firm's management to maintain or increase the level of its holding or to maintain a significant or strategic business relationship with the undertaking. Subscribing to rights issues, for example, would tend to demonstrate that the stake is a strategic one that is intended to contribute to a firm's activities. However, where a firm's management can credibly demonstrate that this is not the case (ie that it does not intend to provide such support in the future or to maintain such business relationships) then it may be appropriate to conclude that a durable link does not exist.

Governance and management

The PRA will also consider a firm's role in the governance and management of the undertaking in considering whether a durable link exists. Representation on the board of directors and other strategic links between the two entities would tend to point towards the existence of a durable link. However, were a firm's management to consider that no such link exists, if it can credibly demonstrate that such relationships are limited in nature and not designed to further its strategic aims, it may be appropriate to conclude that a durable link does not exist.

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