

# Booking models – an accounting point of view

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## Status quo

- London
  - Central booking center for derivatives and other investment banking products
- Issue
  - Impact of Brexit on London used for
    - Booking
    - Settlement
    - Risk management
  - Influence on the dividing line between
    - Booking model strategies and
    - Legal entity strategies
- Financial accounting
  - Only implicitly affected – main concerns directed to more internal topics



## Areas of concerns (ECB, EBA and national supervisors)

Internal  
governance,  
staffing and  
organisation

Business  
origination and  
financial market  
infrastructure

Booking and  
hedging strategy

Intragroup  
arrangements

IT infrastructure  
and reporting

## Summary of concerns

- No operation within
  - An Empty shell
  - A Letter-box entity
  - A brass plate firm
- No back-to-back operation or credit exposure re-financed or secured via intragroup transactions (if the market activity hedged is large enough to threaten the continuity of the EU27 entity in the event of the failure of the institution to which the risks have been transferred)
  - Under such a structure the subsidiary would simply transfer all risks via back-to-back or intragroup transactions to a non-EU 27 parent (instead of identifying and managing the risk stemming from selling financial instruments, derivatives or credit products to EU clients)

## Legal form of business activity

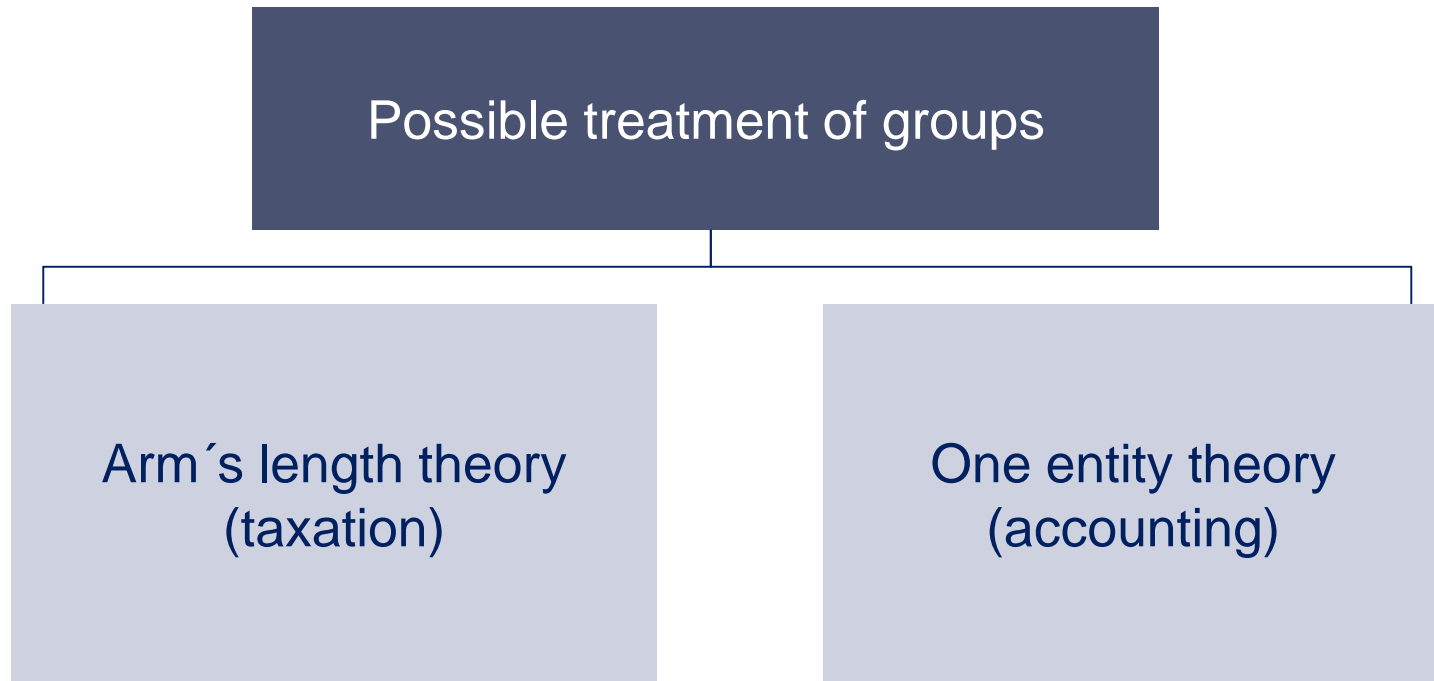
### Branch

- Independent entity conducting business in its own name
- However, not separated from its (foreign) parent company
- Subject to local laws governing its parent company
- Impossible to operate as a stand-alone business
- No stand-alone balance sheet (no single financial statement)

### Subsidiary

- Incorporated legal entity
- Operate in its own right
- Responsible for its own capital and liquidity flow
- Regulated in the country in which it is located
- Fully-founded balance sheet (single financial statement)

## Group accounting (1)





## Group accounting (2)

- Accounting – Illustration of the business of an economic unit
  - Fiction of an economic unit of legally separated companies (consolidated financial statements to present financial information about the group (a parent and its subsidiaries) as a single economic entity)
  - Accounting policies of parent company to be applied for entire group (all subsidiaries)
  - Balance sheet date – the same for parent company and subsidiaries
  - Application of only one currency in the group
  - Elimination of intra-group transactions
  - Typically – if a parent company exists on a higher level within the group, exemption for subordinated companies to prepare consolidated financial statements
- Group financial statements – primarily for information purposes
- Auditing and enforcement – to built (more) trust in financial statements

## Consolidation – elimination of a double count (1)

Balance sheet of parent

Non-current assets	Equity
<b>P's interest in S</b>	Liabilities
Current assets	

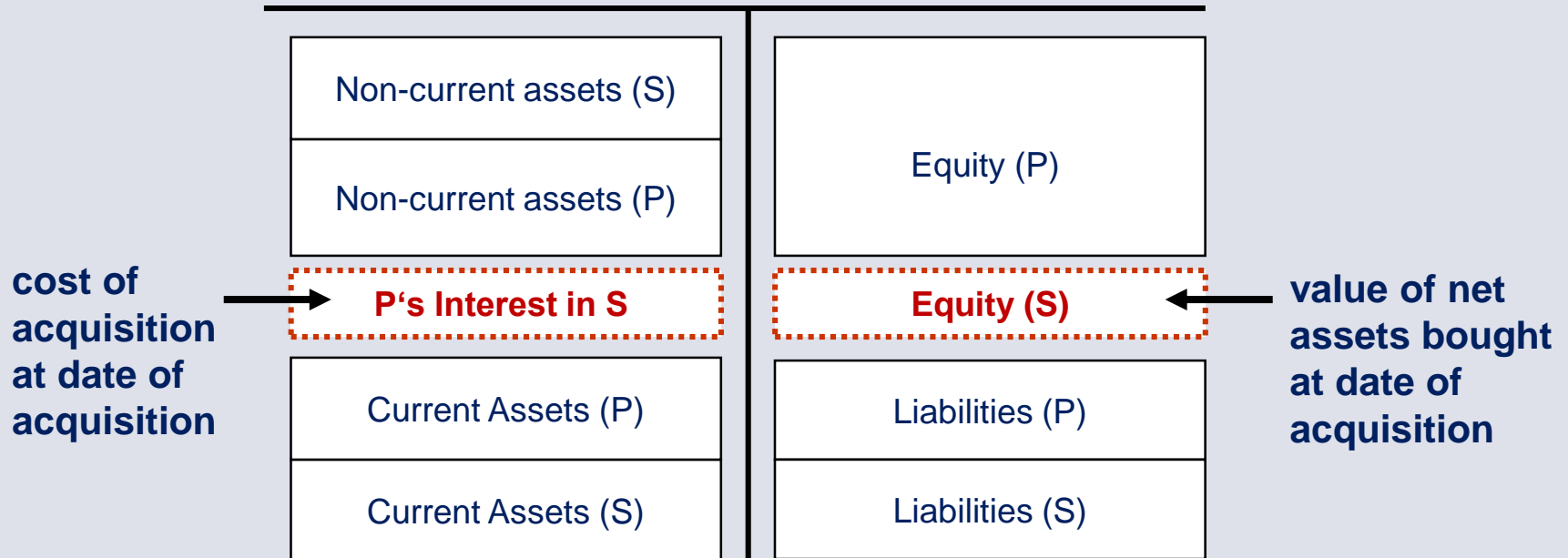
Balance sheet of subsidiary

Non-current assets	<b>Equity</b>
Current assets	Liabilities



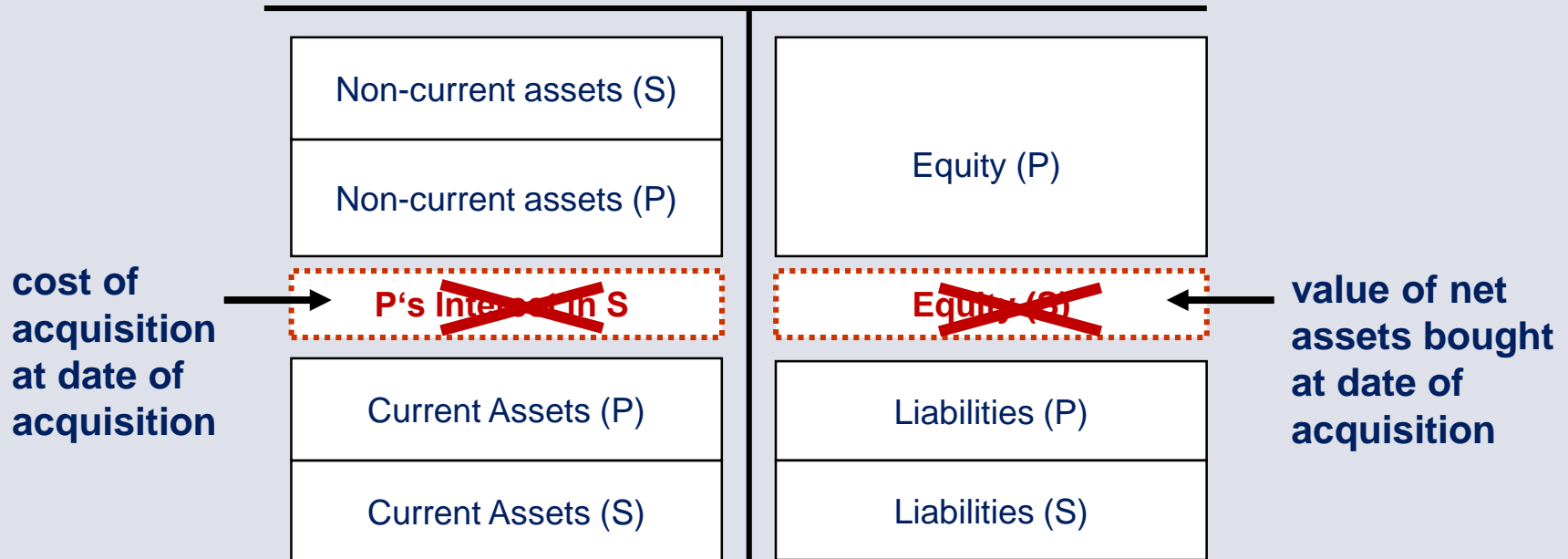
## Consolidation – elimination of a double count (2)

### Line-by-line-combined balance sheet



## Consolidation – elimination of a double count (3)

### Line-by-line-combined balance sheet





## Types of profit or loss items to be eliminated

### Earnings

- Interest income
- Fee income
- Trading income
- Other earnings

### Expenses

- Interest expense
- Fee expense
- Trading expense
- Other expenses

## Two types of financial statements to be disclosed

### Single financial statement

- Every legal entity (regardless whether part of a group)
- Transactions between consolidated entities of a group remain included
- Risk transfer between group members accepted

### Group financial statement

- On level of parent company
- Fiction – for accounting purposes parent and all subsidiaries to be seen as one single entity
- Transactions between entities of a group to be consolidated (eliminated)
- Risk transfer between group members ignored



## Key questions

What are the current booking model arrangements?

What are the main drivers for chosen booking structures?

How is risk managed in chosen legal entities?

How is the booking model controlled?

How can the existing booking model being optimised (also legal form)?



## Experience regarding trading book documentation

No robust documentation (including transfer pricing)

Inconsistent booking-related policies

Limited understanding and transparency of booking practice

Limited understanding of governance, origination, risk management

Limited understanding of supporting operational infrastructure

Limited understanding of end-to-end across legal entities and branches



## Auditor involvement – broad understanding

Products in  
which the bank  
transacts

Legal entities  
involved

Execution of  
trades

Flow of risks  
through the  
group (ultimate  
location of risk)

Risk  
management

## Consequences

### Current status (possibly)

- Transformation initiatives focussed on developing global booking models across classes (for their trading activities) and concentrating both capital and liquidity in UK-domiciled entities



### Future requirements

- Requirement of setting up or upgrade EU-domiciled booking centres, replicating current arrangements in London and effectively spitting their trading booking models



### Potential legal structure

- Branch – no single financial statement (not really fulfilling rational of supervisory requirements)
- Subsidiary – single financial statement as well as being part of group financial statement





## Contact

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