

Regulatory approach to wholly owned subsidiaries: on the day briefing

NHS Improvement (NHSI) has published an addendum to its transactions guidance, detailing its **regulatory approach to wholly owned subsidiaries**. The process detailed in this document applies to both trusts and foundation trusts looking to establish a wholly owned subsidiary, or those looking to changing an existing subsidiary company. The new rules come into effect immediately from 26 November 2018 and NHSI will begin reviewing trust plans that are currently paused.

The regulatory approach will be reviewed within a year. If you have any questions about our work in this area or would like to share your experience of the regulatory process, please contact david.williams@nhsproviders.org and adam.wright@nhsproviders.org.

Key changes to the process

- The creation of all wholly owned subsidiaries (WOSs), and 'material changes' to existing WOSs, are now reportable to NHSI.
- Trusts will be required to submit board-approved business cases detailing the proposals, the underlying financial projections and inherent risks to the regulator.
- An NHSI panel review will deem whether a planned WOS is 'significant' or 'material' based on the inherent risks of the proposal. The outcome of this review will determine what level of oversight and review NHSI will next seek from a trust.
- NHS trusts will also need to demonstrate that its WOS proposal will generate additional income. This will involve a further submission to the Department of Health and Social Care (DHSC).
- A WOS proposal deemed as 'material' will require the submission of a trust board certification confirming that the board has satisfied itself in relation to the inherent risks.
- A 'significant' WOS proposal will require a board certification alongside a more detailed review covering four key domains: strategy, transaction execution, quality and finance.
- Once the detailed review of a 'significant' WOS proposal is complete, NHSI will assign a risk rating which will determine how much NHSI oversight it will be subject to as it proceeds.
- If a proposal is rated as 'red' the trust will be required to restructure the proposal to address the risks concerned. NHSI will look to use its regulatory powers to stop a transaction if required.
- NHSI has committed to reviewing the approach within a year, and intends to align with the existing transactions guidance once there is a better understanding of the inherent risks of subsidiary proposals.

Guidance overview

Panel review process

Any NHS trust or foundation trust looking to establish a WOS, regardless of its size, will now have to report its plans to NHSI. This is also true for trusts looking to establish joint ventures and partly owned subsidiaries that operate as separate and distinct legal entities from trusts (in terms of taxation, regulation and liability).

Trusts will now have to submit a board-approved business case alongside its underlying financial projections and inherent risks to NHSI. These are reviewed by an NHSI panel that will include governance, finance and subject matter experts, as well as members of NHSI's transactions review team. In some cases, trusts will be able to challenge and refuse particular experts.

NHSI will determine the level of scrutiny for a WOS once it has determined the level of inherent risk in the proposal. NHSI will inform a trust of the key risks it has identified, and will classify lower risk transactions as 'material' and higher risk transactions as 'significant'. The panel review should take around three weeks.

Material versus significant

Material

Lower risk WOS proposals will be deemed 'material' and will require the submission of a new and amended trust board certification. The board certification will require the trust to consider WOS plans within wider system plans, and will require a commitment to detail the WOS commercial strategy independent of VAT. This is not something currently required of trusts for other types of transactions.

Trusts may also be required to provide additional evidence on an ad hoc basis. A trust will not be able to establish its subsidiary until NHSI has approved its board certification.

Significant

If the initial panel review deems a WOS proposal to be 'significant', NHSI will scrutinise the plans further. In addition to submission of a trust board certification, a further detailed review will be undertaken across four domains:

- Strategy - *is there a clear strategic rationale for the subsidiary transaction and is the trust board assured that there is the capability, capacity and experience to deliver the strategic objectives of the transaction?*
- Transaction execution - *are the trust and the subsidiary able to execute and implement the transaction successfully?*
- Quality - *is quality maintained or improved as a result of the subsidiary transaction?*
- Finance - *does the transaction result in a financially viable trust and subsidiary?*

NHSI may also undertake a detailed review of the financial projections and will interrogate underlying assumptions and key risks to financial forecasts.

This detailed review will involve interviews and meetings with the trust and other key stakeholders involved in the subsidiary. Toward the end of the review, NHSI will also look to meet or speak with appropriate executives from the trust board.

NHSI intends for the review to last no longer than six weeks. Once the trust has had the ability to respond to the detailed review, NHSI will assign a risk rating of 'green' or 'amber', with the latter meaning the plans will require additional oversight and monitoring as they proceed. If a proposal is rated as 'red' the trust will be required to restructure the proposal to address the risks concerned. NHSI will look to use its regulatory powers to stop a transaction if required.

Additional requirements for NHS trusts

Under the NHS Act 2006, NHS trusts are only allowed to establish a subsidiary company to generate additional income. This means that any NHS trust WOS must be profitable, with all profit invested into improving health services. Existing guidance also states that income should be generated *outside* of the NHS and not from the delivery of core healthcare provision. NHSI has asked trusts not to seek legal advice on this aspect.

NHS trusts will therefore also need to submit a business case to the secretary of state for health and social care for approval. Proposals will need to demonstrate the WOS is able to generate additional income for the trust, and consent will be given on a case-by-case basis. Further guidance will be published shortly, involving next steps and timescales. It's not yet clear whether the NHSI review will take place before the Department of Health and Social Care undertaking. NHS trusts cannot establish a WOS until consent has been given by the secretary of state.

Material changes to existing subsidiary companies

The process detailed in the addendum does not apply to existing subsidiaries, but NHSI does intend to apply this approach to any trust seeking to make a 'material change' to an existing subsidiary company. A 'material change' has not yet been defined, however NHSI recognise they will need to provide further clarification on this.

A panel review process, as detailed above, will take place for subsidiaries that will be 'materially changed'. But for existing subsidiaries, the panel will consider the extent to which the current trust and subsidiary governance process may mitigate against risk.

Next steps

NHSI do not intend for the establishment of all subsidiaries to remain reportable, and in future may set a 'bar' for when proposals should be reported. There is also an intention to set clearer parameters over the

level of review required for those WOSs deemed reportable, and clarify expectations over the risk rating system. NHSI therefore plans to review this new regulatory approach after one year and possibly align the process with the existing transactions guidance. We will look to ensure that trusts play a full role in this review to ensure it is fit for purpose and proportionate.

NHS Providers press statement

The deputy chief executive of NHS Providers, Saffron Cordery said:

“The guidance for overseeing the creation of wholly owned subsidiaries (WOSs) set out today by NHS Improvement rightly acknowledges that WOSs are an appropriate, legitimate and innovative way for NHS trusts to meet the challenges they face. Trusts can and should have the option to set up these entities where there is a proven need.

“Our response to the consultation on this guidance, like that of many other respondents, warned that the regulation and oversight of WOSs must therefore be proportionate and not undermine the benefits they can bring to the sector.

“We are concerned that the level of detail and the steps outlined in the new review process go a long way beyond what is normally expected of trusts and what is required for other transactions and commercial activities. There are many reasons why a trust may choose to establish a WOS. These go well beyond just making tax savings. The process NHS Improvement is choosing to adopt here sets the bar too high and introduces an unwelcome extra administrative burden into the sector. There is a danger that trusts will abandon innovative WOS plans and instead look to less preferable alternatives.

“Many will also see this guidance as part of a worrying trend where the decision making power and autonomy of trusts and foundation trust boards continues to be eroded with more and more control shifted towards the centre. Unitary trust and foundation boards, working as part of local systems, are fully and legally accountable for the services their trusts deliver for good reason – they are in the best position, by far, to ensure that high quality care is provided to the communities their trusts serve. The task of arms length bodies is to support and enable provider boards to fulfil these responsibilities, not unnecessarily restrict them from doing so.

“We welcome the commitment to eventually align the WOS review process with existing transactions guidance. But this should happen as soon as possible. Trusts need a clear understanding on these regulatory requirements.

“Finally, we are pleased that NHS Improvement remains committed to reviewing this process within a year. Trusts must play a full role in any such review.”

Ends.