EBA EUROPEAN BANKING AUTHORITY

Single Rulebook Q&A

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Legal act	Regulation (EU) No 575/2013 (CRR)
Topic	Own funds
Article	37
Paragraph	b
Subparagraph	-
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	Not applicable
Article/Paragraph	NA
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Disclose name of institution / entity	No
Type of submitter	Competent authority
Subject matter	Calculation of goodwill included in the valuation of significant investments in insurance undertakings
Question	A. For the purposes of a deduction under Article 36(1)(b) CRR, should the goodwill (Article 4(1) no. 113 and 115 CRR) included in the valuation of significant investment 1. be calculated at the acquisition date by separating any excess of the acquisition cost over the banking group's share of the net fair value of the identifiable assets and liabilities of the insurance undertaking or 2. be the amount disclosed as goodwill in the IFRS/NGAAP consolidated balance sheet of the parent institution (or parent financial holding company or parent mixed financial holding company, as applicable) in proportion of the participation recorded for prudential purposes (i.e. in case of participation of 100%, the full goodwill should be deducted, including also goodwill generated at the level of the insurance undertaking)?

	B. Would the application of Article 49(1) CRR provide the possibility to risk weight rather than deduct the goodwill included in the valuation of significant investment in insurance undertakings?
Background on the question	Assume bank A acquires 100% of the share capital of insurance B for an acquisition cost of 110. Assume that the net fair value of the identifiable assets and liabilities of insurance B is equal to 100. Assume also that, following the acquisition, insurance B carries out other acquisitions and records on its own balance sheet additional goodwill for 5. Article 37(b) CRR provides that "the amount to be deducted shall include goodwill included in the valuation of significant investments of the institution" however, the provision is not clear on how the goodwill should be calculated. In particular, it is not clear if the goodwill should be limited to the goodwill generated when the significant investment is made (in the example, 10=110-100) or instead if also the goodwill subsequently generated by the acquired subsidiary should be deducted (in the example, 15= (110-100)+5).
Final answer	A. As established in EBA Q&A 2013_383, investments in insurance undertakings are excluded from the prudential scope of consolidation. Moreover, Article 18(7) Regulation (EU) No 575/2013 (CRR) explicitly establishes that, for prudential purposes, institutions shall, as a default treatment, apply the equity method for the valuation of subsidiaries in undertakings that are not institutions, financial institutions or ancillary services undertakings, whilst competent authorities may also allow or require institutions to apply a different valuation method (including the method required by the relevant accounting framework (ie. cost or fair value)) provided that certain conditions are met. Further, according to Article 4(113) CRR, 'goodwill has the same meaning as under the applicable accounting framework'. In this regard, it is worth pointing out that, from an accounting perspective, the IFRS framework already set out the approach for the identification of goodwill in case of participations that are accounted for the equity method. In particular, IAS 28 establishes that the amount to be allocated to goodwill is given by the difference between (i) the cost of the investment and (ii) the entity's share of the net fair value of the investee's identifiable assets and liabilities Based on this approach, in the case as described in the background, the amount of goodwill that is included in the valuation of the participation and shall be deducted from CET1 items would be 10. Including also the goodwill generated after the acquisition would, de facto, result in reflecting, for the purposes of the calculation of own funds, the effects of the consolidation of the insurance undertaking at least with reference to the estimation of the amount of goodwill to be deducted. The amount of goodwill to be deducted would be the same as in the case, where

invested undertakings would be institutions (instead of insurance undertakings) and as such prudentially consolidated, which would be inconsistent with the provisions of Article 18(7) CRR, according to which insurance undertakings that qualify as subsidiaries shall not be consolidated for prudential purposes, but accounted for with the equity method as a default treatment. This would result in an inconsistency between the treatment of goodwill and that of other intangible assets held by the insurance undertaking, despite the fact that also the latter would not have any loss absorbency capacity. Finally, this would entail a sort of “look through” approach (limited only to the recognition of the amount of goodwill to be deducted from CET1 capital) that is not explicitly required in the CRR.

Moreover, as any goodwill subsequently generated at insurance undertaking level will fall under the Solvency II requirements - and valued at zero according to this special regulation – it will not be considered to absorb losses at the level of the insurance group, thus recognizing the lack of loss absorbency of that item already at insurance group level.

Based on the above considerations, for the purposes of a deduction under Article 36(1)(b) CRR, the goodwill included in the valuation of significant investment should be calculated by separating any excess of the acquisition cost over the banking group’s share of the net fair value of the identifiable assets and liabilities of the acquired insurance undertaking.

B.

Article 49(1) CRR provides for an alternative, with the competent authority’s prior authorization, to the deduction regime laid down in article 36(1)(i) CRR for holdings of own funds instruments of insurance undertakings in which the institution has a significant investment. It does however not allow to derogate from the deduction of goodwill, which is mandatory for any, goodwill included in the valuation of significant investment as per Article 37(b) CRR. Furthermore, Article 15j of Regulation (EU) No 241/2014, provides the possibility not to separately identify the goodwill when determining the applicable amount to be deducted for insignificant investments (Articles 46 CRR), but as a matter of fact this provision is limited to insignificant investments in FSE and cannot overrule the treatment established in Article 37(b), which is applicable to significant investments.

Therefore, the permission not to deduct pursuant to Article 49(1) CRR does not imply the non-deduction of the goodwill included in the valuation of significant investments in insurance undertakings and any goodwill included in the valuation of the significant investment in the insurance undertaking shall be in any case fully deducted from own funds in accordance with Article 36(1)(b) and 37(b) CRR.

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