

EBA/CP/2017/20

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09/11/2017

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# Consultation Paper

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Draft Regulatory Technical Standards

on the methods of prudential consolidation under Article 18 of Regulation (EU) No 575/2013 (Capital Requirements Regulation - CRR)

# Contents

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<b>1. Responding to this consultation</b>	<b>3</b>
<b>2. Executive Summary</b>	<b>4</b>
<b>3. Background and rationale</b>	<b>6</b>
<b>4. Draft regulatory technical standards</b>	<b>12</b>
<b>5. Accompanying documents</b>	<b>38</b>
5.1 Draft cost-benefit analysis / impact assessment	38
5.2 Overview of questions for consultation	45

# 1. Responding to this consultation

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The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

## Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 09.02.2018. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

## Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

## Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) N° 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

## 2. Executive Summary

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The EBA has developed this Consultation Paper (CP) for these draft Regulatory Technical Standards (RTS) in accordance with the mandate in Article 18(7) of Regulation (EU) No 575/2013<sup>1</sup> (Capital Requirements Regulation – CRR) pursuant to which the ‘EBA shall develop draft regulatory technical standards to specify conditions according to which consolidation shall be carried out in the cases referred to in paragraphs 2 to 6’ of Article 18 of the CRR.

The current regulatory framework in terms of scope and the methods of prudential consolidation is derived from the CRR, in particular Articles 11 and 18. The entities to be included in the scope of prudential consolidation pursuant to Article 18 of the CRR are institutions (i.e. credit institutions and investment firms), financial institutions (as defined in point 26 of Article 4(1) of the CRR) and, when consolidated supervision is required pursuant to Article 111 of Directive 2013/36/EU, ancillary services undertakings.

Pursuant to Article 18(1) of the CRR, for prudential consolidation purposes, institutions shall fully consolidate all institutions and financial institutions that qualify as their subsidiaries or, where relevant, the subsidiaries of their parent financial holding company or parent mixed financial holding company. However, under certain circumstances, Article 18 CRR allows the application of a different method of consolidation (other than full consolidation) for the purpose of prudential consolidation.

In particular, these draft RTS elaborate on some criteria/indicators and some conditions for the application of different methods of consolidation (full consolidation, proportional consolidation, aggregation method) or the application of the equity method in the following cases:

- Use of proportional consolidation on a case-by-case basis according to the share of capital that a parent undertaking holds in a subsidiary (Article 18(2) of the CRR);
- Use of the aggregation method for undertakings managed on a unified basis pursuant to a contract, memorandum or articles of association; or undertakings’ whose administrative, management or supervisory bodies consist in the majority of the same persons in office (Article 18(3) of the CRR);
- Use of proportional consolidation where participations held in institutions, financial institutions or ancillary services undertakings are managed together with other non-consolidated undertakings (Article 18(4) of the CRR);
- Whether and how consolidation shall be carried out in some specific cases of participations or capital ties (Article 18(5) of the CRR);

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<sup>1</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

- Whether and how consolidation shall be carried out in cases of significant influence without holding a participation or other capital ties and of single management other than pursuant to a contract, memorandum or articles of association (Article 18(6) of the CRR).

Moreover, the Basel Committee on Banking Supervision (BCBS) has published Guidelines on identification and management of step-in risk<sup>2</sup>. According to the BCBS Guidelines, ‘step-in risk’ is the risk that a bank decides to provide financial support to an unconsolidated entity that is facing stress, in the absence of, or in excess of, any contractual obligations to provide such support. The BCBS Guidelines include several indicators that banks should use in order to identify entities bearing step-in risk for the bank. The BCBS Guidelines follow a Pillar II approach and provide certain flexibility on the measures to be applied (such as conversion factors or other measures) to address step-in risk.

Considering the BCBS Guidelines, these draft RTS include several indicators that should be assessed by institutions in order to identify which undertakings can lead to step-in risk. However, they have a more limited scope than the BCBS Guidelines as the purpose of these draft RTS is to determine the methods of prudential consolidation only under a Pillar I approach. Moreover, the draft RTS do not cover all entities that may give rise to step-in risk.

Competent authorities shall also consider these indicators in order to conclude whether the entities included under the scope of prudential consolidation pursuant to Article 18 of the CRR should be fully consolidated, proportionally consolidated or follow the rules of the CRR for holdings of capital instruments of financial sector entities. Institutions should also consider the potential risk to which they are exposed towards those undertakings and consider it under their internal capital adequacy assessment process (ICAAP). Besides, competent authorities can consider other measures to address the potential risk stemming from these undertakings under the supervisory review and evaluation processes (SREP).

## Next steps

This CP is issued for a 3 months consultation period. The final draft RTS will be subsequently submitted to the Commission for endorsement before being published in the Official Journal of the European Union.

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<sup>2</sup> <https://www.bis.org/bcbs/publ/d423.htm>.

## 3. Background and rationale

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The EBA has developed this Consultation Paper (CP) for these draft Regulatory Technical Standards (RTS) in accordance with the mandate in Article 18(7) of the Capital Requirements Regulation (CRR)<sup>3</sup> pursuant to which the ‘EBA shall develop draft regulatory technical standards to specify conditions according to which consolidation shall be carried out in the cases referred to in paragraphs 2 to 6’ of Article 18 of the CRR.

Moreover, the EBA has taken into consideration the work of the Basel Committee on Banking Supervision (BCBS) on the identification and management of step-in risk, which is also relevant for the subject matter of these draft RTS.

### 3.1 Background and regulatory approach followed in the draft RTS

#### Criteria and conditions for the use of the different methods of consolidation

The current regulatory framework in terms of scope and methods of prudential consolidation is enshrined in the CRR, in particular in Articles 11 and 18.

The entities to be included in the scope of prudential consolidation pursuant to Article 18 of the CRR are institutions (i.e. credit institutions and investment firms), financial institutions (as defined in point (26) of Article 4(1) of the CRR) and, when consolidated supervision is required pursuant to Article 111 of Directive 2013/36/EU, ancillary services undertakings (as defined in point (18) of Article 4(1) of the CRR).

Unless a prudential waiver has been granted<sup>4</sup>, the CRR and the CRDIV apply to institutions (credit institutions and investment firms) on an individual and on a consolidated basis, and the general rule for the preparation of their consolidated situation for prudential purposes is full consolidation. In particular, pursuant to Article 18(1) of the CRR, for prudential consolidation purposes, ‘the institutions that are required to comply with the requirements...on the basis of their consolidated situation’ (see Article 11 and seqq.) shall fully consolidate all institutions and financial institutions that are their subsidiaries or, where relevant, the subsidiaries of their parent financial holding company or parent mixed financial holding company. However, under certain circumstances, Article 18 CRR allows the application of a method of consolidation other than full consolidation for prudential consolidation.

In fact, Article 18(2) of the CRR provides an exception to the general rule of full consolidation of subsidiaries by allowing proportional consolidation of a subsidiary in certain instances, subject to the permission of the relevant competent authority on a case-by-case basis, upon application from the

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<sup>3</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

<sup>4</sup> For instance, article 7 CRR provides for a waiver of solo prudential requirements (own funds, capital requirements, large exposures, exposures to transferred credit risk, leverage, disclosure by institutions) to subsidiaries established within the same Member State as their parent institutions granted on a case-by-case basis by the competent authority.

supervised entity. Pursuant to this provision, proportional consolidation according to the share of the capital held by the parent undertaking in the subsidiary can be applied if the liability of the parent undertaking is limited to the share of capital that the parent undertaking holds in the subsidiary, the liability of the other shareholders and members is clearly established in a legally binding way, and the solvency of the other shareholders or members is satisfactory.

Moreover, according to Article 18(3), (5) and (6) of the CRR the competent authorities shall determine the method of consolidation applicable in cases of relationships other than those covered in paragraphs 1 and 2 of Article 18 of the CRR. Furthermore, Article 18(4) of the CRR requires the application of the method of proportional consolidation in one additional case.

More specifically, Article 18(3) of the CRR refers to undertakings managed on a unified basis pursuant to a contract, memorandum or articles of association; or undertakings whose administrative, management or supervisory bodies consist in the majority of the same persons in office during the financial year and until the consolidated financial statements are drawn up. In this case, the draft RTS determine that the method of consolidation (aggregation method) should follow the rules of Directive 2013/34/EU<sup>5</sup> (Accounting Directive) and specifically that consolidated financial statements must be prepared in accordance with paragraphs 8 and 9 of Article 22 of that Directive.

Proportional consolidation is required by Article 18(4) of the CRR where participations held in institutions, financial institutions or ancillary services undertakings are managed together with other non-consolidated undertakings. However, the liability of each undertaking is limited to the share of the capital they hold, so that the institution will provide support which is proportional to its share of the capital only. The draft RTS specify that the conditions set out in this paragraph are met in cases of joint arrangements as defined by IFRS 11 *Joint arrangements* (IFRS 11).<sup>6</sup>

It is worth noting that in this case the application of proportional consolidation for the purpose of prudential consolidation may differ from the approach for financial accounting. Specifically, according to IFRS 11 (applicable from 1 January 2014) a joint venturer shall recognise its interest in a joint venture using the equity method.<sup>7</sup>

However, for prudential purposes there are several reasons to require the use of the proportional method of consolidation:

- It allows to reflect the risks of the entities managed together and promotes an integrated approach to risk management by requiring a detailed assessment via a “look through” approach of the underlying assets, liabilities and off-balance sheet positions of the undertakings;

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<sup>5</sup> Article 18(3) of the CRR refers to Article 12(1) of Directive 83/349/EEC. This Directive was repealed on 26 June 2013 by the Directive 2013/34/EU. For this reason, references in these draft RTS has been made to Directive 2013/34/EU.

<sup>6</sup> Commission Regulation (EU) No 1254/2012 of 11 December 2012 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Financial Reporting Standard 10, International Financial Reporting Standard 11, International Financial Reporting Standard 12, International Accounting Standard 27 (2011), and International Accounting Standard 28 (2011).

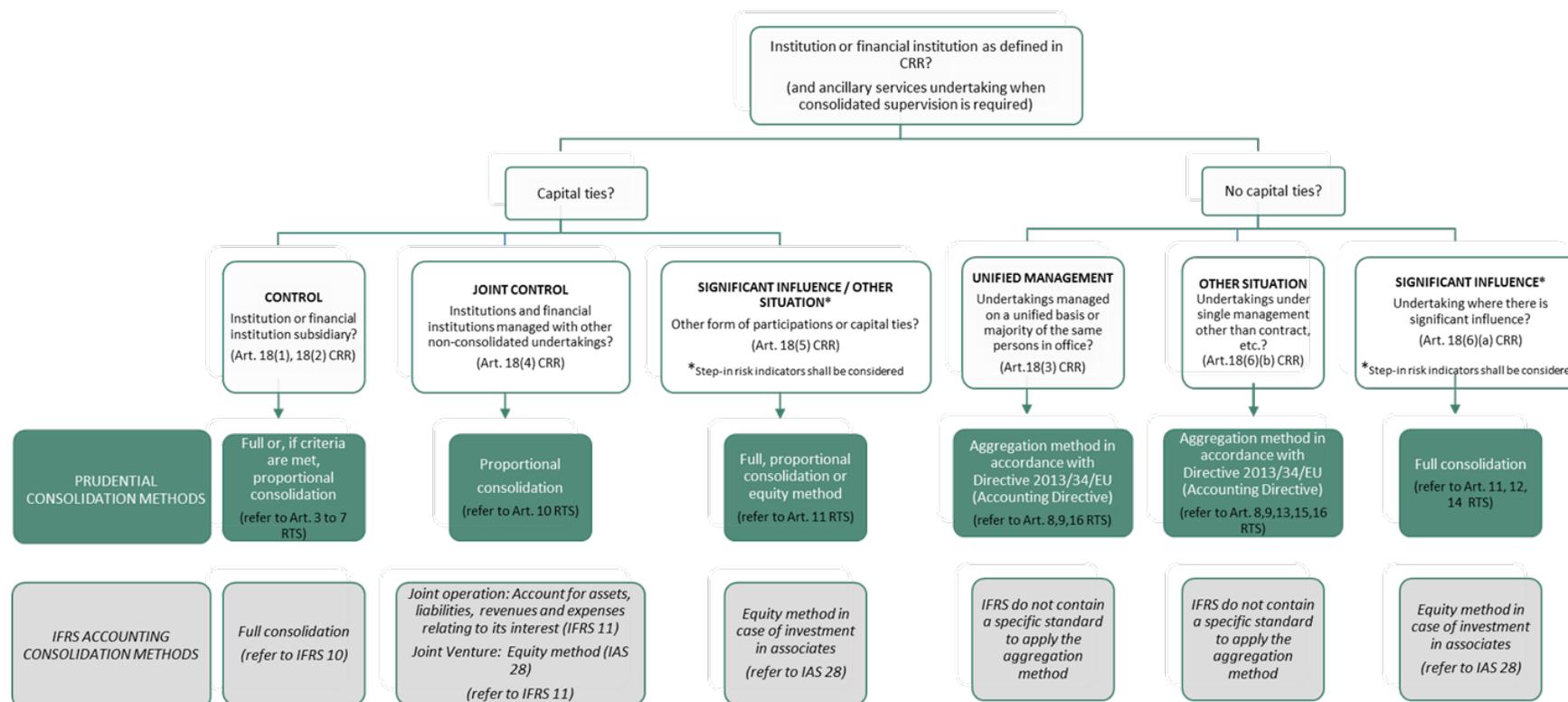
<sup>7</sup> IFRS 11 also includes an exemption for the application of the equity method in certain cases.

- As the liability to these undertakings is limited to the share of capital held, it addresses the prudential risks related to the contractual exposures consistently;
- As these undertakings may have similar risk profiles to institutions (for which the current prudential framework was designed), proportional consolidation could appropriately capture these risks; and
- A common approach to the treatment of these participations increases comparability when the accounting standards may provide room for judgement (e.g. assessment of joint arrangements for their classification as joint operations - which are proportionally consolidated - or joint ventures - which are accounted using the equity method).

Article 18(5) of the CRR deals with participations or capital ties other than those referred to in Article 18(1) and (4) of the CRR. The draft RTS define under which circumstances consolidation should be required by the relevant competent authority and in which way the undertaking should be integrated into the consolidated situation of the parent (meaning, for example, full or proportional consolidation) or alternatively, where the application of the equity method should be considered appropriate.

Article 18(6)(a) and (b) of the CRR deal, respectively, with the discretion for competent authorities to require prudential consolidation in the case of significant influence without a participation or other capital ties, and in the case of single management other than pursuant to a contract, memorandum or articles of association. The draft RTS describe how significant influence can be assessed and the method of prudential consolidation. Moreover, the draft RTS set forth the indicators that may lead to the conclusion that two or more institutions or financial institutions are placed under single management. When two or more institutions or financial institutions are placed under single management the aggregation method, as proposed for the application of Article 18(3) of the CRR, should be applied.

Figure explaining the possible alternatives covered in these draft RTS



## **Other framework that should be considered in the context of the draft RTS: Step-in risk and limits on exposures to shadow banking entities**

The Basel Committee on Banking Supervision (BCBS) has published Guidelines on identification and management of step-in risk<sup>8</sup>. According to the BCBS Guidelines, 'step-in risk' is the risk that a bank decides to provide financial support to an unconsolidated entity that is facing stress, in the absence of, or in excess of, any contractual obligations to provide such support. The main reason for accepting step-in risk might be to avoid the reputational risk that a bank might face if it does not provide support to a related entity facing stress. The BCBS Guidelines include several indicators that banks should use in order to identify entities giving rise to step-in risk for the bank. The objective of the BCBS Guidelines is to identify only those instances where step-in risk would significantly impact the bank's liquidity and/or capital positions. The BCBS Guidelines focus on the situations that give rise to step-in risk, rather than trying to provide a list of entities that should be included. Nevertheless, at a minimum, according to the BCBS Guidelines, banks are expected to scrutinise securitisation vehicles, investment funds and other entities which are described in the guidelines.

Considering the above mentioned work, the draft RTS include several indicators that should be assessed by institutions when identifying which undertakings can actually lead to step-in risk. Competent authorities shall also consider these indicators to conclude whether the entities included under the scope of prudential consolidation pursuant to Article 18 of the CRR should be fully consolidated, proportionally consolidated or follow the rules of the CRR for holdings of capital instruments of financial sector entities.

Institutions should also consider the potential risk to which they are exposed in these undertakings and consider it under its internal capital adequacy assessment process (ICAAP). Besides, competent authorities can consider other measures to address the potential risks from these undertakings under the supervisory review and evaluation processes (SREP). Given the mandate envisaged in Article 18 of the CRR, the draft RTS have a more limited scope than the BCBS Guidelines as it covers Pillar I measures and therefore do not expand on the possible measures to be taken by the institutions and the competent authorities as part of the ICAAP and SREP. Moreover, the draft RTS do not cover all entities that may give rise to step-in risk.

The EBA has also issued Guidelines on limits on exposures to shadow banking entities, which specify the methodology that should be used by institutions to set limits, as part of their internal processes, on their individual and aggregate exposures to shadow banking entities.<sup>9</sup> These Guidelines should be read in conjunction with these draft RTS.

## **EBA Opinion and Report on other financial intermediaries and regulatory perimeter issues**

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<sup>8</sup> <https://www.bis.org/bcbs/publ/d423.htm>.

<sup>9</sup> EBA Guidelines on limits on exposures to shadow banking entities which carry out banking-like activities outside a regulated framework under Article 395(2) of Regulation (EU) No 575/2013, EBA/GL/2015/20, 14 December 2015.

The EBA has published an Opinion and a Report on the prudential treatment of other financial intermediaries (OFIs) and regulatory perimeter issues<sup>10</sup> which provides a summary of issues identified by the competent authorities in the application of the definition of financial institution and ancillary services undertaking. The OFIs Opinion and Report highlight that there is currently some diversity on the application of these definitions and recommend clarification.

### **Other considerations on Article 18 of the CRR**

According to Article 18(8) of the CRR, it is worth noting that where consolidated supervision is required pursuant to Article 111 of Directive 2013/36/EU, ancillary services undertakings shall be included in the prudential scope of consolidation in accordance with the methods laid down in these draft RTS.

Lastly, on 23 November 2016, the Commission published a proposal to amend Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR) and Directive 2013/36/EU (Capital Requirements Directive – CRDIV). Some of these proposals include changes in some parts of the existing Article 18 of the CRR, mainly the removal of the possibility to apply proportional consolidation for subsidiaries (Article 18(2) of the CRR). The EBA will follow the developments of the CRR proposals and decide whether, after the public consultation of these draft RTS, any changes to the draft RTS are needed due to these developments. However, the EBA does not consider necessary to withhold the public consultation of the draft RTS until the CRR review is finalised since the changes currently proposed are deemed to be limited.

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<sup>10</sup> <https://www.eba.europa.eu/-/eba-publishes-an-opinion-and-report-on-regulatory-perimeter-issues-relating-to-the-crdiv-crr>

## 4. Draft regulatory technical standards

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In between the text of the draft RTS that follows, further explanations on specific aspects of the proposed text are occasionally provided, which either offer examples or provide the rationale behind a provision, or set out specific questions for the consultation process. Where this is the case, this explanatory text appears in a framed text box.

## COMMISSION DELEGATED REGULATION (EU) No .../..

of **XXX**

[...]

**supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards to specify conditions according to which consolidation shall be carried out under Article 18(7).**

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 642/2012<sup>11</sup>, and in particular Article 18(7) thereof,

Whereas:

- (1) Article 18 of Regulation (EU) No 575/2013 deals with the methods of prudential consolidation for undertakings included in its scope.
- (2) Article 18(2) of Regulation (EU) No 575/2013 applies only to undertakings that meet the definition of subsidiaries and therefore does not cover the other types of relationship covered by the other paragraphs of Article 18 of Regulation (EU) No 575/2013.
- (3) Article 18(3) of Regulation (EU) No 575/2013 covers prudential consolidation in cases where a parent-subsidiary relationship does not exist and it is considered that in those cases the most appropriate method to prepare the consolidated financial statements for prudential purposes is the aggregation method in accordance with the rules of the Directive 2013/34/EU<sup>12</sup> (Accounting Directive). The absence of a parent-subsidiary relationship creates the need to determine the consolidating entity when the aggregation method is applied.
- (4) Article 18(4) of Regulation (EU) No 575/2013 requires proportional consolidation where participations held in institutions and financial institutions are managed together with other non-consolidated undertakings. However, this requires that the liability of the participating undertakings is limited to the share of the capital held by each party. The

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<sup>11</sup> OJ L 176, 27.6.2013, p.1.

<sup>12</sup> Article 18(3) of the CRR refers to Article 12(1) of Directive 83/349/EEC. This Directive was repealed on 26 June 2013 by the Directive 2013/34/EU. For this reason, references in these draft RTS has been made to the Directive 2013/34/EU.

draft RTS should specify these criteria further and requires the presence of unanimous consent for the application of proportional consolidation.

- (5) The Basel Committee on Banking Supervision (BCBS) has published Guidelines on identification and management of step-in risk<sup>13</sup> which include several indicators that should be used by institutions in identifying which entities can give rise to step-in risk. According to the BCBS Guidelines, 'step-in risk' is the risk that a bank decides to provide financial support to an unconsolidated entity (i.e. not fully or proportionately consolidated) that is facing stress, in the absence of, or in excess of, any contractual obligations to provide such support. When the bank identifies that there is significant step-in risk, it needs to determine the appropriate measures based on the nature and extent of the anticipated step-in support in each case. These measures vary from the inclusion in the regulatory scope of consolidation; the application of a conversion factor (like for off-balance-sheet exposures); liquidity requirements; punitive ex-post capital charges; large exposure-like internal limit; etc. Banks need to report their self-assessment of step-in risk to the competent authority on a periodic basis.
- (6) Article 18(5) of Regulation (EU) No 575/2013 entrusts the competent authority with the task of deciding whether and how consolidation is to be carried out in case of participations or capital ties other than those referred to in paragraphs 1 and 4 of Article 18 of Regulation (EU) No 575/2013.
- (7) Paragraphs (a) and (b) of Article 18(6) of Regulation (EU) No 575/2013 refer to the supervisory requirements for prudential consolidation in the case of significant influence without participation or other capital ties, and in the case of single management other than pursuant to a contract, memorandum or articles of association. In case of institutions or financial institutions controlled by central governments (or regional or local governments), a single management is not expected to occur, except where the Competent Authority has concrete evidence that there is an effective coordination of the financial and operating policies of such institutions or financial institutions.
- (8) In line with the BCBS Guidelines, this Regulation includes several indicators to be considered by institutions and competent authorities to conclude whether the undertakings should be fully consolidated, proportionally consolidated or follow the rules of the CRR for holdings of capital instruments of financial sector entities taking into account of the potential risk these undertakings may pose. Institutions should also consider alternative measures to address this potential risk under their risk management procedures and internal capital adequacy assessment process (ICAAP). Besides this, competent authorities can consider other measures to address the potential risk from these undertakings under the supervisory review and evaluation processes (SREP).
- (9) In addition, this Regulation allows competent authorities the possibility to apply proportional consolidation in other situations than those covered by Article 18(4) of Regulation (EU) No 575/2013.
- (10) The EBA has also issued Guidelines on limits on exposures to shadow banking entities which carry out banking-like activities outside a regulated framework. Those Guidelines specify the methodology that should be used by institutions to set limits, as part of their internal processes, on their individual and aggregate exposures to shadow banking entities. These Guidelines should be read in conjunction with this Regulation.

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<sup>13</sup> <https://www.bis.org/bcbs/publ/d423.htm>.

- (11) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.
- (12) EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010.<sup>14</sup>

HAS ADOPTED THIS REGULATION:

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<sup>14</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

## *Title I: Subject matter, scope of application and definitions*

### *Article 1*

#### *Subject matter and scope of application*

This Regulation specifies conditions according to which consolidation shall be carried out under Article 18(7) of Regulation (EU) No 575/2013 in order to apply the prudential requirements on a consolidated basis in accordance with Article 11(1) of Regulation (EU) No 575/2013.

#### **Explanatory box for the consultation**

The scope of application of this Consultation Paper (CP) is limited to those entities included in the definition of ‘undertaking’ referred to in Article 2 of this CP and therefore financial institutions and ancillary services undertakings are included under the scope. However, additional clarifications of the definition of financial institution in Article 4(1)(26) CRR and of ancillary services undertakings in Article 4(1)(18) CRR are not under the mandate of this CP. The definition of ‘financial institution’ and ‘ancillary services undertaking’ is an important supervisory aspect to consider as only institutions, financial institutions and ancillary services undertakings are included in the scope of prudential consolidation. In this regard, it is important that the consolidation requirements are not circumvented based on the assessment that an entity is not a financial institution or an ancillary services undertaking.

A potential example where there may be a need for interpretation relates to asset management companies created to manage repossessed real estate assets resulting from non-performing loans, or SPE issuing capital or funding instruments to the market. Even if the main activities of such undertakings may not be explicitly listed in Annex I of the Directive (EU) 2013/36/EU, they are created to serve the purpose of the institution and to exert activities that could also be done directly by the institution itself. In this sense, they may also qualify as an ancillary services undertaking. The fact that some activities or assets are transferred to another entity should not be used to circumvent the rules of Regulation (EU) 575/2013.<sup>15</sup> Consequently, a competent authority should be in a position to exert consolidated supervision on these entities and to require, after careful assessment, their inclusion in the consolidated scope of supervision notably when they are created by the institution which supports substantially their risks.

The EBA has published an Opinion and a Report on the prudential treatment of other financial intermediaries (OFIs) and regulatory perimeter issues<sup>16</sup> which provides a summary of issues identified by competent authorities in the application of the definition of financial institution and ancillary services undertakings. The OFI Opinion and Report highlight that there is currently some diversity on the application of these definitions. In this regard, as signaled in the Opinion, the EBA considers that

<sup>15</sup> It should be noted that, in addition to the consolidation rules, it is relevant to consider whether the assets transferred to other entities should be derecognised from the balance sheet, and therefore the interaction between the consolidation and the derecognition rules.

<sup>16</sup> <https://www.eba.europa.eu/-/eba-publishes-an-opinion-and-report-on-regulatory-perimeter-issues-relating-to-the-crd-iv-crr>

there would be merit in taking further steps to better clarify the definition of financial institution and an ancillary services undertaking.

In addition, the EBA OFI Report found that there is a variety of practices in Member States on whether ‘securitisation special purpose entity’ or ‘SSPE’ (as defined in Article 4(1)(66) of the CRR), for which specific rules are established in relation to the transfer of significant risks under Articles 243 and 244 of the CRR, are considered financial institutions and on their inclusion in the scope of prudential consolidation.

The CRR establishes specific prudential rules when the SRT rules apply (the institution is the originator of the securitised exposures) and specific risk-weights when the institution is acting as an investor in a securitisation transaction. An example relates to the securitisation transactions that are done to improve the liquidity of the institution but not to transfer risk and consequently the SSPE is consolidated for accounting purposes. Another example could be where a bank underwrites the total amount of a junior note issued by a SSPE in a securitisation where the bank is not the originator. In this case, an alignment between the prudential and accounting scope may be warranted.

The EBA would like to have a better understanding about the differences between the accounting and the prudential scope of consolidation in these situations.

**Question 1: Are there entities which do not comply with the definition of financial institution or ancillary services undertaking as set out in Regulation (EU) No 575/2013 which should be included in the prudential scope of consolidation? Please explain and provide examples of these entities.**

**Question 2: Do you consider SSPEs financial institutions? When SSPEs are consolidated for accounting purposes, do you also consolidate them for prudential purposes? Please differentiate in your answer between the situation when SRT is met and when it is not met (the institution originates the securitisation); when the institution acts as an investor in the securitisation issued by the vehicle; and when the institution sponsors the securitisation transaction.**

## *Article 2*

### *Definitions*

For the purposes of this Regulation, the following definitions shall apply:

‘Capital ties’ means the ownership, direct or indirect, of the capital instruments of an undertaking.

‘Significant influence in absence of participations or capital ties’ means situations where an institution has the ability to participate in the financial and operating policy decisions of another undertaking without holding any participation or other capital ties in that undertaking and which is not considered a subsidiary as defined by Article 4(16) of Regulation (EU) No 575/2013.

‘Undertaking’ means:

- A ‘credit institution’ as defined in Article 4(1)(1) of Regulation (EU) No 575/2013;
- An ‘investment firm’ as defined in Article 4(1)(2) of Regulation (EU) No 575/2013;
- A ‘financial institution’ as defined in Article 4(1)(26) of Regulation (EU) No 575/2013;
- An ‘ancillary services undertaking’ as defined in Article 4(1)(18) of Regulation (EU) No 575/2013 when consolidated supervision is required pursuant to Article 111 of Directive 2013/36/EU;
- An undertaking established in a third country, which, were it established in the European Union, would fulfil the definition of credit institution, investment firm, financial institution or ancillary services undertaking as defined in Article 4 of Regulation (EU) No 575/2013.

#### **Explanatory box for the consultation**

According to IAS 28 *Investments in Associates and Joint Ventures*<sup>17</sup> ‘significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those polices’. In addition, IAS 28.5 states that ‘If an entity holds, directly or indirectly (e.g. through subsidiaries), 20 per cent or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the entity holds, directly or indirectly (e.g. through subsidiaries), less than 20 per cent of the voting power of the investee, it is presumed that the entity does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.’

According to Article 2(13) of the Directive 2013/34/EU an undertaking is presumed to exercise a significant influence over another undertaking where it has 20% or more of the shareholders' or members' voting rights in that other undertaking.

The draft RTS provide a definition of ‘significant influence in absence of participations or capital ties’ to clarify the application of Article 18(6)(a) of Regulation (EU) 575/2013 as the accounting standards refer to the existence of some voting rights when referring to significant influence. Nevertheless, this definition is guided by the definition of significant influence included in IAS 28.

In addition, it should be noted that the Regulation (EU) 575/2013 does not include a specific definition of ‘undertaking’ although this term is used in several articles of the CRR. These draft RTS include a definition of ‘undertaking’ only for the purposes of these draft RTS.

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<sup>17</sup> Commission Regulation (EU) No 1254/2012 of 11 December 2012 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Financial Reporting Standard 10, International Financial Reporting Standard 11, International Financial Reporting Standard 12, International Accounting Standard 27 (2011), and International Accounting Standard 28 (2011).

*Title II: Permission for proportional consolidation of subsidiaries under Article 18(2) of  
Regulation (EU) No 575/2013*

*Article 3*

*Application for permission to use proportional consolidation*

1. A parent undertaking may request permission from the competent authority to consolidate a subsidiary that is subject to paragraph 1 of Article 18 of Regulation (EU) No 575/2013 in proportion to the share of the capital it holds in such subsidiary.
2. The application shall be submitted to the competent authority in written form and shall be accompanied by appropriate supporting documentation including the contract referred to in Article 5 of this Regulation.

*Article 4*

*Permission to apply proportional consolidation*

1. The permission to apply proportional consolidation may be granted only in cases where all the conditions specified in Articles 5 to 7 of this Regulation are met to the satisfaction of the competent authority.
2. The competent authority shall have at least 3 months to decide whether to grant the permission to apply proportional consolidation. The 3 month period shall start on the date of receipt of the complete final application and supporting documentation.

*Article 5*

*Contract limiting the liability of the shareholders or members*

1. The liability of the parent undertaking and the other shareholders or members in respect of the subsidiary shall be established by means of a legally binding contract between that parent undertaking and the other shareholders or members of the subsidiary, together holding the totality of the share of capital of the subsidiary. The contract shall meet all of the following conditions:
    - a) The limitation of the liability of the parties shall be clearly established in the contract and shall be defined as a percentage of the total shareholding.
    - b) The contract shall clearly state that any potential losses arising from the subsidiary will be borne by the shareholders or members proportionately to the share of capital held by each of them at such point in time.
    - c) The contract shall clarify that any changes in the share of capital of the shareholders or the members are subject to the explicit consent of all the shareholders or members.
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- d) The contract shall specify that should the subsidiary be recapitalised, institutions shall timely inform the competent authority about the progress made in the recapitalisation process. Each shareholder or member shall contribute to the recapitalisation in proportion to its current share of the capital of the subsidiary.
- e) There shall be no other agreements or side-agreements in the articles of association or separate memoranda between some or all of the shareholders or members of the subsidiary, or between some or all of the shareholders or members of the subsidiary and any third party, that override or undermine any of the conditions under a), b), c) and d) above.

### *Article 6*

#### *Changes in the shareholders' or members' contract*

1. The parent undertaking shall inform the competent authority at least 3 months in advance of any changes in the contract that affect the conditions listed in Article 5.
2. The competent authority shall provide the parent undertaking with a formal decision on whether proportional consolidation of the subsidiary is still appropriate or full consolidation shall be required.
3. In case of termination of the contract, the parent undertaking shall inform the competent authority without delay ahead of the effective date of termination.
4. The termination of the contract shall result in the full consolidation of the subsidiary from the date the termination becomes effective.

### *Article 7*

#### *Requirements relating to the solvency of other shareholders or members*

1. When applying for the permission to apply proportional consolidation, the parent undertaking shall demonstrate that the solvency of the other shareholders or members of the subsidiary at individual and consolidated levels, where appropriate, is satisfactory and can be reasonably expected to remain so, by providing appropriate documentation to the competent authority.
2. The other shareholders or members shall be financial sector entities subject to prudential supervision and shall fulfill the criteria of financial soundness as set in Article 23(1) of the Directive 2013/36/EU on an on-going basis.

#### **Explanatory box for the consultation**

Article 18(2) of Regulation (EU) No 575/2013 allows competent authorities on a case-by-case basis to permit the application of proportional consolidation for subsidiaries if certain conditions are fulfilled. This is an exception to the normal treatment covered in Article 18(1) of Regulation (EU) No 575/2013

as subsidiaries are generally fully consolidated. The draft RTS specify the conditions included in Article 18(2) of Regulation (EU) No 575/2013.

The EBA carried out a stock-take among competent authorities to gather information on the application of Article 18(2) of Regulation (EU) No 575/2013 and understands that this Article has been used in very few countries for a limited number of institutions that were not material. The CP includes a question to interested parties to have further information on the use of this paragraph of Article 18 of Regulation (EU) No 575/2013.

It is also worth noting that this method will result in a different treatment for accounting and for prudential purposes as subsidiaries are always fully consolidated for accounting purposes.

The EBA also notes that the Commission has proposed some amendments to Article 18 in the context of the CRR/CRD review and one of these amendments include the removal of the current Article 18(2) from Regulation (EU) No 575/2013. Therefore, the final content of these draft RTS might change considering the developments in the CRR review.

**Question 3: Do you currently use the method of proportional consolidation for the consolidation of subsidiaries in accordance with Article 18(2) of Regulation (EU) No 575/2013? If proportional consolidation is used, please explain if the conditions included in this Consultation Paper are met.**

**Question 4: Do you have any comments on the conditions established in this Consultation Paper to apply proportional consolidation pursuant to Article 18(2) of Regulation (EU) No 575/2013?**

*Title III: Consolidation of undertakings managed on a unified basis or by the same persons under Article 18(3) and Article 18(6)(b) of Regulation (EU) No 575/2013*

*Article 8*

*Determination of the consolidating entity in case of groups of undertakings managed on a unified basis or by the same persons*

1. Where there is only one institution authorised in the European Union within a group of undertakings which are managed on a unified basis or by the same persons pursuant to Article 22(7) of Directive 2013/34/EC and Article 18(6)(b) of Regulation (EU) No 575/2013, the consolidating entity is this institution.
2. Where there are institutions established in one or more Member States within a group of undertakings which are managed on a unified basis or by the same persons pursuant to Article 22(7) of Directive 2013/34/EC and Article 18(6)(b) of Regulation (EU) No 575/2013, the consolidating entity is the institution with the largest balance sheet total, resulting from the latest

audited consolidated financial statements, where prepared, or in the cases where consolidated financial statements are not required to be prepared, the latest audited individual financial statements.

3. In particular cases, the relevant competent authorities may agree to waive the criteria referred to in paragraph 2 where their application would be considered inappropriate, and designate another institution as consolidating entity. For the purpose of such an assessment, the competent authority should take into consideration, among other things, the peculiarities of the institutions, the relative importance of their activities in different countries and the occurrence of specific provisions in the national regulation that already defines for accounting purposes the criteria for determining the consolidating entity. In such cases, before taking their decision, the competent authorities shall give the institution with the largest balance sheet total an opportunity to state its opinion on that decision.
4. The consolidating entity determined in accordance with this Article shall be considered to be the parent institution for the purpose of application of the requirements on a consolidated basis pursuant to Article 11(1) of the Regulation (EU) No 575/2013.

#### **Explanatory box for the consultation**

This Article clarifies which entity should be responsible for the consolidation within the group in the absence of a parent-subsidiary relationship pursuant to Article 22(7) of Directive 2013/34/EC and Article 18(6)(b) of Regulation (EU) No 575/2013. This is necessary to determine which entity is in charge of the consolidated reporting and compliance with the consolidated requirements.

This entity is responsible for the compliance with the obligation laid down in Part Two to Four and Part Seven of Regulation (EU) 575/2013 on the basis of the consolidated situation of the group, and is treated as a parent institution. In addition, the consolidating institution, and other institutions included in the scope of consolidation pursuant to Article 18(3) or (6)(b) of Regulation (EU) No 575/2013, are subject to the requirements on the basis of their individual financial situation.

**Question 5: Do you agree on the criteria for the determination of the consolidating entity? Do you experience a different situation currently?**

#### *Article 9*

##### *Method of prudential consolidation*

1. Where the conditions of Article 22(7) of Directive 2013/34/EC are met, the undertakings managed on a unified basis or in major part by the same persons in office during the financial year and until the consolidated financial statements are drawn up, shall prepare consolidated financial statements in accordance with Article 22(8) and (9) of Directive 2013/34/EC. Subsidiaries or

undertakings subject to proportional consolidation in accordance with Article 18 of Regulation (EU) No 575/2013 shall be included in the scope of prudential consolidation.

**Question 6: Do you have any comment on the elements included in this Consultation Paper for the application of the 'aggregation method' pursuant to Articles 18(3) and (6)(b) of Regulation (EU) No 575/2013? Please explain.**

#### **Explanatory box for the consultation**

Article 18(3) of the Regulation (EU) No 575/2013 refers to Article 12(1) of Directive 83/349/EEC. However, this Directive was repealed on 26 June 2013 by the Directive 2013/34/EU. In particular, Article 12(1) of Directive 83/349/EEC was replaced by Article 22(7) of Directive 2013/34/EC. Article 22(7) of Directive 2013/34/EC refers to the case where:

a) two or more undertakings which are not related, as described in paragraphs 1 or 2 of Article 22, are managed on a unified basis in accordance with a contract, or a memorandum or articles of association; or

b) the administrative, management or supervisory bodies of two or more undertakings which are not related, as described in paragraphs 1 or 2 of Article 22, consist in the majority of the same persons in office during the financial year and until the consolidated financial statements are drawn up.

The situation of entities 'managed on a unified basis' in accordance with Article 22(7)(a) of Directive 2013/34/EC could happen, for instance, where the undertakings:

- are managed as a single unit;
- share a single interest;
- are fully owned, controlled and/or managed by the same natural person(s) (i.e. as the natural person is not included in the scope of prudential consolidation).

The situation of entities which are managed in major part by the same persons in office during the financial year and until the consolidated financial statements are drawn up in accordance with Article 22(7)(b) of Directive 2013/34/EC could happen, for instance, when the persons in office have executive functions giving them the ability to control and manage the affairs of these undertakings (e.g. Directors or members of the Board);

IFRS 3 *Business Combinations*<sup>18</sup> does not specify a method to prepare consolidated financial statements where no parent-subsidary relation exists<sup>19</sup> and different practices may exist. In this

<sup>18</sup> Commission Regulation (EC) No 495/2009 of 3 June 2009 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Financial Reporting Standard (IFRS) 3.

<sup>19</sup> Business combinations under common control are excluded from the scope of IFRS 3 *Business Combinations*.

regard, the Accounting Directive includes an aggregation method which should be used for prudential consolidation where the conditions in Article 18(3) of Regulation (EU) No 575/2013 are met.

The following steps need to be followed for consolidating undertakings managed on a unified basis, or which the administrative, management or supervisory bodies of the undertakings consist in the majority of the same persons in office during the financial year and until the consolidated financial statements are drawn up:

- Application of uniform accounting policies;
- Aggregation of assets, liabilities, equity, income and expenses;
- Elimination of cross-holding participations (and the proportion which they represent of the capital and reserves of the undertaking according to the rules of the Accounting Directive), if any;
- Elimination of assets and liabilities, profit and losses, income and expenses related to intragroup transactions.

The aggregation method will not lead to the recognition of any minority interest between the undertakings as they do not meet the definition of minority interest in Article 4(120) of Regulation (EU) No 575/2013 (i.e. capital of a subsidiary of an institution that is attributable to natural or legal persons other than those included in the prudential scope of consolidation of the institution). Article 16 of this Regulation includes some specific criteria for the recognition of consolidated Common Equity Tier 1, Additional Tier 1 and Tier 2 capital owned by natural or legal persons other than the undertakings included in the prudential scope of consolidation.

#### **Example the use of the aggregation method**

The aggregation method is proposed to be used as the method of prudential consolidation under Articles 18(3) and (6)(b) of Regulation (EU) No 575/2013 as in these cases, no parent-subsidary relationship exists.

The aggregation method is based on the annual financial statements of the individual undertakings which are part of the group (or the sub-consolidated financial statements where appropriate).

The following example refers to a case where bank A and B are 100% owned by a natural person or a non-EU parent. The next steps are followed:

- All balance sheet positions of the group member undertakings are summed up to aggregated numbers (*italic text* in the example); and
- Elimination of intra-group loans and debts and any participation in the capital of the other undertakings (**bold text** in the example).

All balance sheet positions of the group undertakings are summed up to aggregated numbers (right hand side of the example).

<b>Bank A</b>						<b>Bank A and B group</b>	
cash	100	deposits	455	cash	160	deposits	705
loans	400	other liabilities	300	loans	550	other liabilities	385
(of which: to B) <b>20</b>		(of which: to B) <b>70</b>		securities	470	T 1	105
securities	300	T 1	60	tangible assets	45	T 2	30
participation B	<b>5</b>	T 2	20				
tangible assets	30						
	<u>835</u>		<u>835</u>		<u>1225</u>		<u>1225</u>
<b>Bank B</b>							
cash	60	deposits	250				
loans	240	other liabilities	175				
(of which: to A) <b>70</b>		(of which: to A) <b>20</b>					
securities	170	T 1	<b>50</b>				
tangible assets	15	(of which: to A) <b>5</b>					
		T 2	10				
	<u>485</u>		<u>485</u>				

*Title IV: Proportional consolidation of undertakings with limited liability under  
Article 18(4) of Regulation (EU) No 575/2013*

*Article 10 Conditions to apply proportional consolidation*

1. Competent authorities shall require institutions to proportionately consolidate under Article 18(4) of Regulation (EU) No 575/2013 undertakings according to the share of capital held on these undertakings, if their participations in these undertakings fulfil all of the following conditions:
  - a. The voting rights and decision-making process in the undertaking in which the participation is held is based on a contractual arrangement with other shareholding undertakings (the “participating undertakings”).
  - b. The institution manages the undertaking together with one or more participating undertakings sharing the control.
  - c. The decision related to the relevant activities of the undertaking requires the unanimous consent of the parties sharing control.
  - d. A legally enforceable contract should establish that the liability of the participating undertakings is limited to the share of the capital each party holds in the undertaking.

2. Where all the conditions of paragraph 1 are met, proportional consolidation according to the share of capital held in undertakings shall be carried out following the rules for proportional consolidation included in Article 26 of Directive 2013/34/EC.

**Explanatory box for the consultation:**

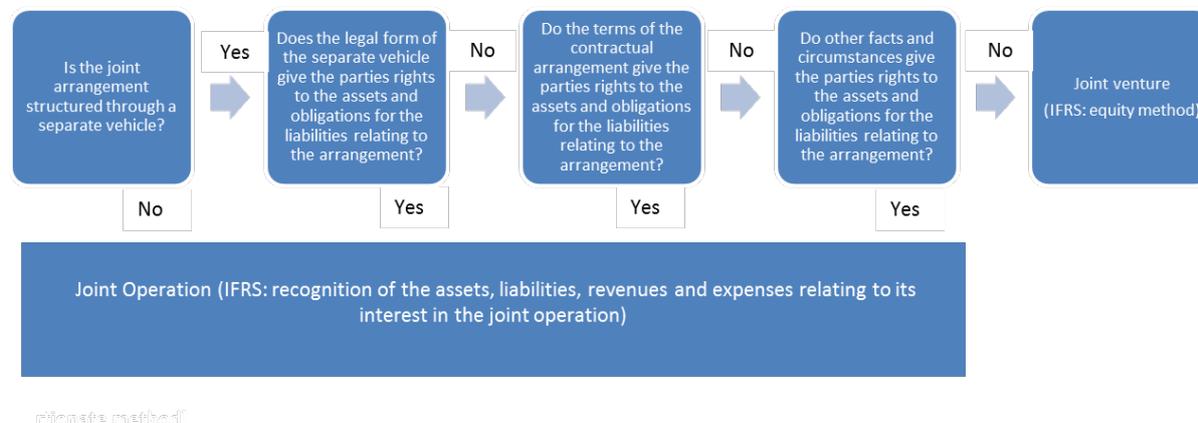
Article 18(4) of Regulation (EU) No 575/2013 requires the application of proportional consolidation where participations in an institution, financial institution and ancillary services undertaking are managed by an undertaking included in the consolidation together with other participating undertakings not included in the consolidation. This paragraph of Article 18 of Regulation (EU) 575/2013 has been developed further in this CP to clarify the conditions to apply proportional consolidation, which includes the unanimous consent of the parties sharing control. This is based on IFRS 11 *Joint Arrangements* (IFRS 11) which defines a joint arrangement as ‘an arrangement of which two or more parties have joint control’. According to IFRS 11 joint control is ‘the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control’.

It should be noted that the application of the proportional consolidation may result in a divergence from the accounting treatment. According to IFRS 11 a joint arrangement is either a joint operation or a joint venture. A joint operation is a ‘joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangements’. A joint venture is a ‘joint arrangement whereby parties that have joint control of the arrangement have rights to the net assets of the arrangement’. For joint ventures, IFRS 11 requires the application of the equity method<sup>20</sup> which therefore would be different from the treatment required by Regulation (EU) 575/2013 (i.e. proportional consolidation). Article 26 of Directive 2013/34/EC allows the use of proportional consolidation when an undertaking included in a consolidation manages another undertaking jointly with one or more undertakings not included in that consolidation. Proportional consolidation shall be used in these instances when the criteria included in this Article are met.

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<sup>20</sup> IFRS 11 also includes an exemption for the application of the equity method in certain cases.

*Flow chart on IFRS 11*



Source: EBA based on the flow charts included in IFRS 11

**Question 7: Do you have any comment on the application of proportional consolidation according to Article 18(4) of Regulation (EU) No 575/2013?**

*Title V: Treatment of other participations or capital ties (including equity method) under Article 18(5) of Regulation (EU) No 575/2013*

*Article 11*

*The prudential treatment of other participations or capital ties (including the equity method) under Article 18 (5) of Regulation (EU) No 575/2013*

1. A competent authority shall determine the consolidation method to be used based on the specifications set out in paragraphs 2 to 7 on a case-by-case basis. This does not, however, preclude the competent authority from deciding on a consolidation method of general applicability to be used for participations and/or other capital ties than those referred to in Article 18(1) and Article 18(4) of Regulation (EU) No 575/2013.
2. In the case of participations or capital ties other than those referred to in paragraphs 1 and 4 of Article 18 of Regulation (EU) No 575/2013, the accounting treatment should be followed and the equity method would generally be applied. In particular, the equity method may apply where the competent authority considers that the concerned undertaking does not need to be included in supervision on a consolidated basis.
3. Where participations or other capital ties lead to full or proportional consolidation in accordance with the accounting treatment but are not included in the prudential scope of consolidation in

accordance with Regulation (EU) No 575/2013, the competent authority should review the valuation method of those participations or capital ties applied by institutions for the definition of the solvency ratio.

4. The competent authority may require institutions to apply proportional consolidation limited to the share of capital held where:
  - a. an undertaking is owned by several institutions acting jointly without unanimous consent required with regard to the management and operation of the undertaking and with an agreement between shareholders to support it jointly; or
  - b. there is strong evidence that the institutions will support the relevant undertakings in proportion to their investments.
5. Upon request of the competent authority, institutions shall provide to the competent authority an assessment of the different elements included in this paragraph for their participations or capital ties in undertakings. When assessing the application by an institution of the appropriate prudential treatment of participations or capital ties in an undertaking, the competent authority shall at least consider the following elements:
  - a. the overall ownership structure of the undertaking, having regard in particular as to whether shares or participating interests and voting rights, including potential voting rights in accordance with Article 12(2), are distributed across a large number of shareholders or the institution is the main investor;
  - b. whether the institution acts as sponsor by managing or advising the undertaking, placing the undertaking's securities into the market, or providing liquidity and or credit enhancements to the undertaking, or undertakings where the institution is an important investor in its debt or equity instrument, or where there is other contractual and non-contractual involvement exposing the institution to the risks or to equity-like returns from the assets of the undertaking or related to its performance;
  - c. whether the institution is effectively involved in the decision-making process of the undertaking or the degree to which the institution exercises influence over the undertaking;
  - d. whether the institution receives critical operational services from the undertaking which cannot be replaced in a timely fashion without excessive cost;
  - e. whether the credit rating of the undertaking is based on the institution's own rating;
  - f. whether specific features relating to the composition of the investor base of the undertaking exist, with particular reference to whether the other investors in the undertaking have a close commercial relationship with the institution, their ability to bear losses or their ability to dispose of their financial instruments;

- g. whether the undertaking and the institution have a common customer base or are involved in the commercialisation of each other's products;
  - h. whether the institution and the undertaking have the same brand;
  - i. whether the institution has already provided financial support to the undertaking in case of financial difficulties.
6. The competent authority shall assess the risk posed by the undertaking to the institution after taking into account the existence of any risk mitigants. The competent authority shall assess the extent and the effectiveness of any risk mitigants and consider whether the undertaking should be consolidated - and therefore subject to the CRR requirements at the consolidated level - and the impact on the solvency ratio of the group resulting from applying full consolidation, proportional consolidation or the rules of Regulation (EU) No 575/2013 on holdings of capital instruments of financial sector entities.
7. In particular, the competent authority may require full consolidation where, as a consequence of organisational and financial relationships, the institution is exposed in substance to the majority of the risks and/ or of the benefits arising from the activities of the undertaking.

**Explanatory box for the consultation:**

Article 18(5) of Regulation (EU) No 575/2013 deals with participations or capital ties other than those referred to in paragraphs 1 and 4 of Article 18 of Regulation (EU) No 575/2013. The CP includes different elements that shall be considered by competent authorities when setting the appropriate prudential approach. Some of these elements build on the work of the BCBS on identification and management of step-in risk which include several indicators that should be used in identifying which undertakings can give rise to step-in risk. According to the BCBS Guidelines, 'step-in risk' is the risk that a bank decides to provide financial support to an unconsolidated entity that is facing stress, in the absence of, or in excess of, any contractual obligations to provide such support.

In line with Regulation (EU) No 575/2013, the CP refers to the competent authority assessment on whether the undertaking should be fully or proportionally consolidated and therefore subject to Regulation (EU) No 575/2013 requirements at the consolidated level taking into consideration the risk that the undertaking imposes on the institution; and on the impact on the solvency of the group of applying full consolidation, proportional consolidation or following the rules in Articles 43 to 48 of Regulation (EU) No 575/2013 for holdings of capital instruments of financial sector entities. In this assessment, the impact on solvency should be assessed to identify whether any of these measures may artificially improve the own funds position of the institution.

Upon request of the competent authority, institutions shall provide to the competent authority an assessment of the different elements included in these draft RTS to determine whether it would be appropriate to include the undertakings under the scope of prudential consolidation. In any case, institutions should consider the potential risk to which they are exposed in these undertakings and consider it under their risk management process, including its internal capital

adequacy assessment process (ICAAP) referred to in Article 73 of Directive 2013/36/EU. Competent authorities may also consider other measures to address the potential risk from these undertakings under the supervisory review and evaluation process (SREP) referred to in Article 97 et seq. of Directive 2013/36/EU.

In addition, Q&A 2013\_383 clarifies that pursuant to Article 18 of Regulation (EU) No 575/2013 only institutions and financial institutions are included in the scope of prudential consolidation. Moreover, Q&A 2013\_382 clarifies that where consolidated supervision is required pursuant to Article 111 of Directive 2013/36/EU, ancillary services undertakings are included in the scope of prudential consolidation. Therefore, other entities (e.g. insurance undertakings) are excluded from the scope of Article 18(5) of Regulation (EU) No 575/2013. In such cases, an insurance undertaking may be fully consolidated for accounting purposes but need to be de-consolidated for prudential purposes. Institutions have to decide on a valuation of the corresponding participation and/or other capital ties which are not included in the scope of prudential consolidation. It is therefore necessary to provide the competent authority with the discretion to assess the accuracy of the valuation method used (Article 11(3) of the CP).

In addition, the EBA Guidelines on limits on exposures to shadow banking entities<sup>21</sup> which carry out banking-like activities outside a regulated framework would complement the draft RTS for entities that are excluded from the scope of prudential consolidation. These Guidelines specify the methodology that should be used by institutions to set limits, as part of their internal processes, on their individual and aggregate exposures to shadow banking entities. For instance, there could be step-in risk for shadow banking entities and the EBA Guidelines would provide some limits to these exposures.

This Article of the CP also clarifies that a competent authority may determine a general policy for the treatment of other participations or capital ties under Article 18(5) of Regulation (EU) No 575/2013 (e.g. proportional consolidation or the equity method). However, they may decide to deviate from that general policy depending on the particular circumstances of individual cases.

In addition, this Article of the CP includes the possibility to apply proportional consolidation in some circumstances:

- a) When an undertaking is managed together but no unanimous consent is required in that respect, and there is an agreement between the shareholders to support it jointly. This may e.g. be relevant for institutions that cooperate regarding specific services and therefore own certain undertakings together.
- b) If there is strong evidence that the institutions will support the undertakings in proportion to their investment. Currently, competent authorities in some Member States require the application of proportional consolidation for all participations in institutions and financial institutions (treated under the equity method in accounting).

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<sup>21</sup>[https://www.eba.europa.eu/documents/10180/1310259/EBA-GL-2015-20+GL+on+Shadow+Banking+Entities\\_EN.pdf/ca01acf7-46c9-49d1-9f1a-92f3531df1cf](https://www.eba.europa.eu/documents/10180/1310259/EBA-GL-2015-20+GL+on+Shadow+Banking+Entities_EN.pdf/ca01acf7-46c9-49d1-9f1a-92f3531df1cf)

**Question 8. Do you have any comments on the criteria established in this Consultation Paper on the prudential treatment of other participations or capital ties (including the equity method) under Article 18(5) of Regulation (EU) No 575/2013? Please explain.**

*Title VI: Consolidation of undertakings where there is significant influence or the undertakings are under single management under Article 18(6) of Regulation (EU) No 575/2013*

*Article 12*

*Meaning of significant influence under Article 18(6)(a) of Regulation (EU) No 575/2013*

1. The existence of significant influence by an institution in the absence of participations or capital ties can be demonstrated by, but is not limited to, direct or indirect evidence of one or more of the following features:
  - i. Having a representative or being able to appoint a representative in the management body, the management body in its supervisory function or any similar body of the undertaking;
  - ii. Participation in policy-making processes, including participation in decisions about dividends and other distributions;
  - iii. Existence of material transactions with the undertaking;
  - iv. Interchange of managerial personnel;
  - v. Provision of essential technical information or critical services;
  - vi. Enjoyment of additional rights in the undertaking, by virtue of a contract or of a provision contained in the articles of association or other constitutional documents of the undertaking, that could affect the management or the decision-making of the undertaking.
2. The existence of share warrants, share call options, debt instruments that are convertible into ordinary shares or other similar instruments that are currently exercisable or convertible and have the potential, if exercised or converted, to give the institution voting power or to reduce another party's voting power over the financial and operating policies of the undertaking shall be considered in the assessment of significant influence.

### *Article 13*

#### *Meaning of placed under single management other than pursuant to a contract or clauses of their memoranda or articles of association under Article 18(6)(b) of Regulation (EU) No 575/2013*

1. Two or more undertakings are placed under single management if those undertakings, which are not connected with each other according to Article 22(1) or (2) of Directive 2013/34/EU, are placed under single management other than pursuant to a contract or provisions in the memorandum or articles of association.
2. In order to verify the existence of the situation referred to in paragraph 1 competent authorities can take into account the following indicators:
  - a. two or more institutions or financial institutions are controlled by the same natural person; by the same group of natural persons; by an entity or the same group of entities that are not included in the regulatory scope of consolidation; or by an entity or the same group of entities that are not established in a Member State of the European Union.
  - b. where the majority of the management body, the management body in its supervisory function or any similar body of two or more institutions or financial institutions is composed of people appointed by the same entity or entities, by the same natural person or by the same group of natural persons, even if they do not necessarily consist of the same people.
3. In any case, the occurrence of a situation in which two or more undertakings are placed under single management, shall be based on a case by case assessment by the competent authority, aimed at verifying that in practice there is effective coordination of the financial and operating policies of the abovementioned undertakings.

### *Article 14*

#### *Method of consolidation where significant influence is deemed to exist*

1. When an institution exercises a significant influence over another undertaking without holding any participation or other capital ties, the competent authority shall assess the risks that the undertaking poses to the institutions exercising the significant influence and the impact on the solvency of the group on the basis of the elements listed in Article 11(5) and (6) of this Regulation.
2. In particular, the competent authority may require full consolidation where, as a consequence of organisational and financial relationships, the institution is exposed in substance to the majority of the risks and/ or of the benefits arising from the activities of the undertaking.

Article 18(6)(a) of the Regulation (EU) No 575/2013 covers situations where there is a significant influence but there are no participations or other capital ties in one or more institutions or financial institutions. For instance, this may be the case for special purpose entities (SPEs) which may be carrying out any of the activities falling within the definition of a financial institution according to Article 4(1)(26) of Regulation (EU) No 575/2013. In this case, according to this Regulation the competent authority should assess the risks that the SPE poses to the institutions and the impact on the solvency of the group on the basis of the elements included in paragraphs 5 and 6 of Article 11 of this CP and whether the application of full consolidation is appropriate. As there are no capital ties, proportional consolidation is not considered a possible alternative. In addition, as previously mentioned it is expected that the elements of paragraphs 5 and 6 of Article 11 of this CP would be considered by institutions in determining whether it would be appropriate to include the undertakings under the scope of prudential consolidation. If it is not deemed appropriate to include the undertakings, institutions may also consider the potential risk to which they are exposed in these undertakings and consider it under their internal capital adequacy assessment process (ICAAP). In addition, competent authorities may consider other measures to address the potential risk from these undertakings under the supervisory review and evaluation processes (SREP).

#### *Article 15*

##### *Method of consolidation where two or more institutions or financial institutions are placed under single management*

1. Where two or more institutions or financial institutions are placed under single management according to Article 18(6)(b) of Regulation (EU) No 575/2013 the determination of the consolidating entity and the method of prudential consolidation required in Articles 8 and 9 of this Regulation should be followed and Article 22(8) and (9) of Directive 2013/34 applies.

##### *Title VII: Inclusion of capital instruments owned by natural or legal persons other than the undertakings included in the consolidation*

#### *Article 16*

##### *Consolidated Common Equity Tier 1, Additional Tier 1 and Tier 2 capital owned by natural or legal persons other than the undertakings included in the prudential scope of consolidation*

1. The inclusion in the calculation of the consolidated own funds of Common Equity Tier 1, Additional Tier 1 and Tier 2 own funds instruments issued by undertakings, share premium accounts, retained earnings and other reserves related to these instruments, when the method of prudential consolidation set out in Article 9 is applied for consolidated financial statements shall be conditional on the fact that the related own funds instruments will support the losses of all these undertakings. Where the related own funds instruments do not support the losses of all the

undertakings, such own funds instruments, share premium accounts, retained earnings and other reserves related to these instruments, should be recognised in accordance with the provisions set out in Articles 81 to 88 of Regulation (EU) No 575/2013.

2. Where two or more institutions are placed under unified/single management according to Article 18(3) or Article 18(6)(b) of Regulation (EU) No 575/2013 by the same natural or legal person, the share of capital the natural or legal person holds in these undertakings is presumed to support the losses of all the undertakings and shall be included in the calculation of the consolidated own funds.

#### **Explanatory box for the consultation**

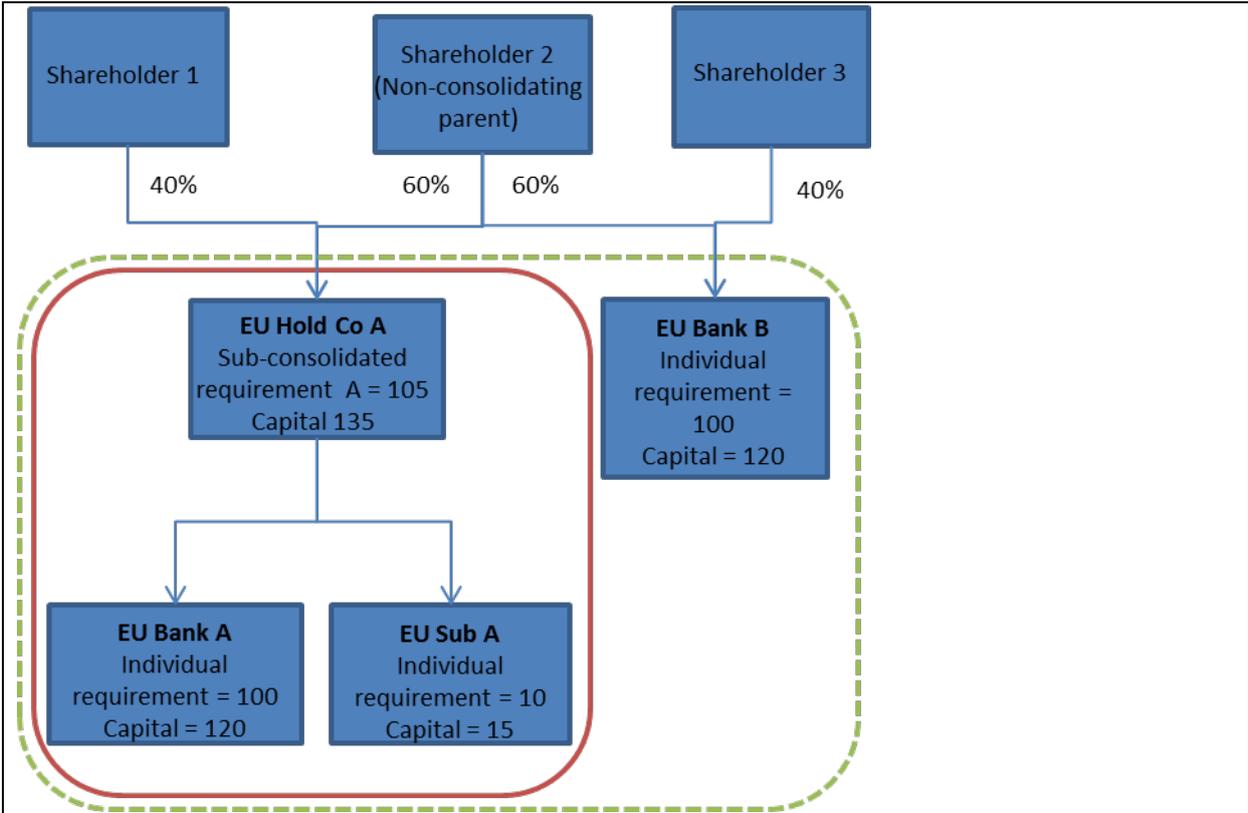
Where two (or more) entities that have been consolidated under Article 18(3) and Article 18(6)(b) of Regulation (EU) No 575/2013 are placed under single management by the same entity (non-EU) or natural person and there are other shareholders which are different between the two (or more) control/ownership chains), the starting presumption is that the amount of own funds that can be recognised in the EU consolidation will be restricted to those that meet the requirements of the institutions in a similar fashion to the provisions in Articles 81 to 88 of Regulation (EU) No 575/2013 and any surplus above this would not be recognised. The exception to this would be where the entities can prove to the satisfaction of the competent authorities that the surplus funds in each entity are freely transferable between all the entities in the EU consolidation. This is likely to require some form of additional contractual agreement as entities in this situation cannot otherwise rely on the surplus funds provided by shareholders who are not part of their own direct ownership chain.

The following example illustrates this case:

The non-consolidating parent owns 60% of a financial holding company (A) and a bank (B) located in the EU. There are other shareholders holding 40% in the holding company and the bank. In this case, their 40% will be considered equivalent to a 'minority interest' (as though there was a standard parent-subsidiary relationship and the 40% was a minority interest) and the rules of the CRR on minority interest would be applied. Therefore, capital belonging to shareholders who would not have a 'parent' relationship with the relevant entities can be recognised in capital but any excess over the minimum capital requirements should not be recognised .

In this example, it would be possible to recognise in capital the following amount =  $(135-12=123) + (120-8=112) = 235 = (\text{sub-consolidated capital A} - 40\% \text{ of surplus}) + (\text{Bank B individual (solo) capital} - 40\% \text{ of surplus})$

CRR 18.3 or 18.6b consolidation 

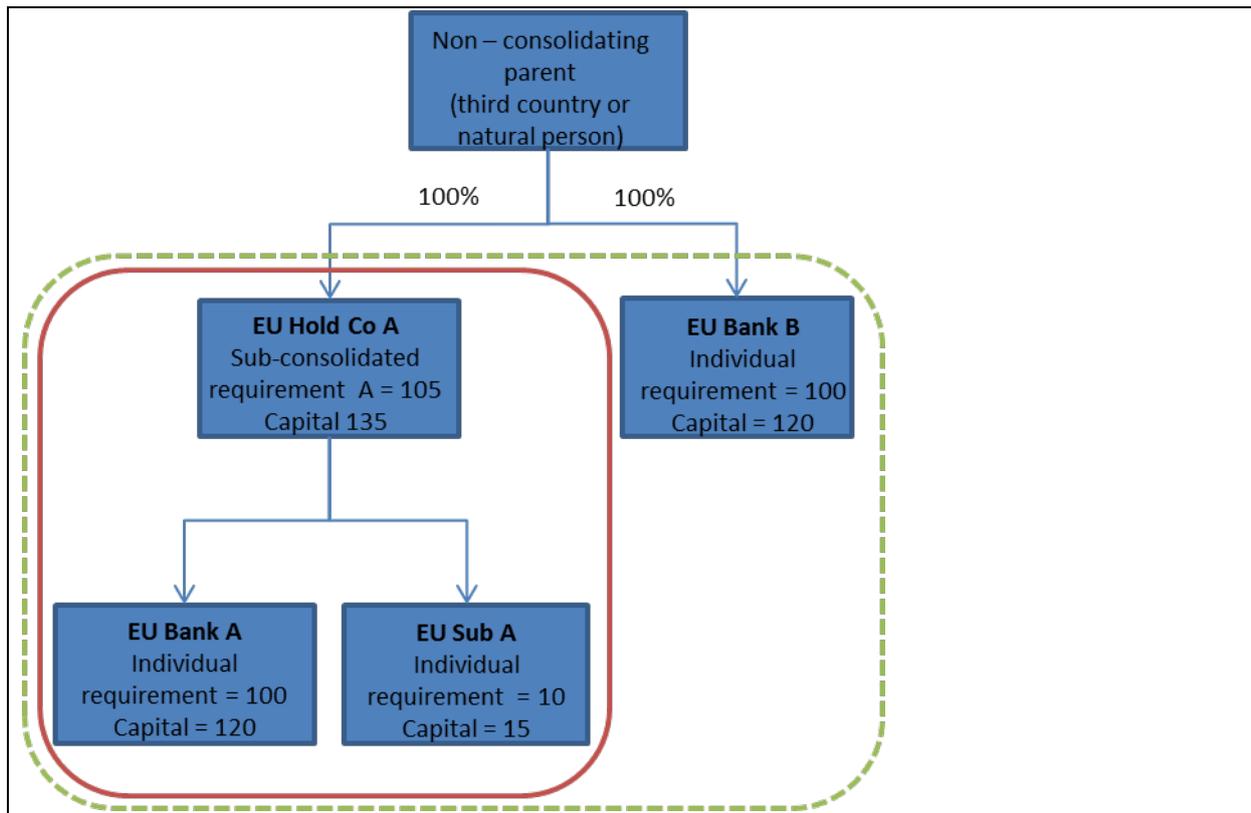


Where two (or more) entities that have been consolidated under Article 18(3) and Article 18(6)(b) of Regulation (EU) No 575/2013 are fully owned by the same parent entity (or the same natural person), particularly where they are part of the same global consolidation group, but are sibling entities in the EU (e.g. the common parent is in a third country), there should be no automatic restriction on the amount of own funds and share premium accounts, retained earnings and other reserves related to these instruments that can be recognised in the EU consolidation. The fact they are fully owned by a common ultimate parent entity, particularly if they are included in the same global regulatory and accounting consolidations, is a strong presumption that the own funds instruments, share premium accounts, retained earnings and other reserves related to these instruments will be available to support the losses in all the undertakings through the consolidation with the ultimate parent.

The following example illustrates this case:

The non-consolidating parent owns 100% of a financial holding company (A) and a bank (B) located in the EU. There are no other minority interests and the total capital due to the aggregation of the sub-consolidation A and bank B can be recognised in own funds.

CRR 18.3 or 18.6b consolidation ■ ■ ■



3. With regard to Additional Tier 1 and Tier 2 capital issued by undertakings which are proportionally consolidated according to Article 18(4) and Article 18(5) of Regulation (EU) No 575/2013, and to Common Equity Tier 1, Additional Tier 1 and Tier 2 capital of undertakings which are fully consolidated under Article 18(5) and Article 18(6)(a) of Regulation (EU) No 575/2013, the inclusion of this capital in the consolidated own funds, share premium accounts, retained earnings and other reserves related to these instruments, shall be determined in accordance with the provisions set out in Articles 81 to 88 of Regulation (EU) No 575/2013. The amount of Additional Tier 1 and Tier 2 capital from the calculation to be included from each undertaking under Article 18(4) and Article 18(5) of Regulation (EU) No 575/2013 shall be multiplied by the share of capital the institution holds in the undertaking where proportionally consolidated.

**Explanatory box for the consultation:**

Article 82 of Regulation (EU) No 575/2013 defines qualifying additional Tier 1, Tier 1, Tier 2 capital and qualifying own funds referring only to subsidiaries. This paragraph of the CP clarifies that Additional Tier 1 and Tier 2 capital issued by undertakings that are proportionally consolidated can also be included as part of total capital to the extent that they support the relevant proportion of that undertaking.

In addition, it is also clarified that the inclusion of Common Equity Tier 1, Additional Tier 1 and Tier 2 capital of undertakings which are fully consolidated under Article 18(5) and Article 18(6)(a) of Regulation (EU) No 575/2013 due to the application of these draft RTS and therefore which are

not consolidated due to the application of Article 18(1) of the CRR shall be determined in accordance with the provisions set out in Article 81 to 88 of Regulation (EU) No 575/2013.

*Title VIII: Entry into force*

*Article 17*

This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

*For the Commission  
The President*

*[For the Commission  
On behalf of the President*

*[Position]*

## 5. Accompanying documents

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### 5.1 Draft cost-benefit analysis / impact assessment

Article 10(1) of the EBA Regulation provides that any submission of regulatory technical standards (RTS) from the EBA to the Commission for adoption should be accompanied by an impact assessment which, inter alia, includes the analysis of ‘the related potential costs and benefits’. To this end, the present section provides an impact assessment (IA) of the draft RTS. It includes an overview of the existing problem which the draft RTS deals with, the options proposed for resolving the problem as well as the potential impact of these options.

#### A. Problem identification

The EBA has developed these draft RTS in accordance with the mandate in Article 18(7) of the CRR under which the EBA shall develop draft regulatory technical standards to specify the conditions according to which consolidation shall be carried out in the cases referred to in paragraphs 2 to 6 of Article 18 of the CRR.

Article 18 of the CRR establishes the method of prudential consolidation of institutions and financial institutions. It also requires the consolidation of ancillary services undertakings when consolidated supervision is required pursuant to Article 111 of Directive 2013/36/EU.

The application of the appropriate method of consolidation ensures that institutions and financial institutions are subject to the application of CRR requirements on a consolidated basis. An inappropriate method of consolidation or the exclusion from the consolidation of some of these undertakings may hide or underrepresent the risk that these undertakings pose to the group. In addition, the variety of practices arising from the application of Article 18 of the CRR results in the application of various methods of consolidation or valuation methods (such as the equity method) in different member states of the EU.

Moreover, in some cases institutions may also have incentives beyond their contractual obligations to step-in and provide financial support to an unconsolidated undertaking that faces stressed financial conditions. This could happen to avoid any kind of reputational risk that the institution may suffer from the failure or default of the undertaking under stress.

In 2016, the EBA carried out a survey across Member States on the application of Article 18 of the CRR. Overall, member states follow the accounting treatment for prudential purposes. However, the survey identified some differences such as that: i) a few competent authorities permit the application of proportional consolidation for subsidiaries in accordance with Article 18(2) CRR; ii) the application of proportional consolidation for undertakings accounted under the equity method for accounting purposes; and iii) the application of full consolidation for prudential purposes when



the institution is exposed, in substance, to the majority of the risk and/or the benefits arising from the activities of the undertaking in question.

The EBA performed a follow-up of this stock-take to some Member States<sup>22</sup> and confirmed that overall the proposed draft RTS will not have a significant impact across EU on the methods of consolidation currently applied. In addition, the methods of consolidation may change over time for some particular types of entities in some jurisdictions. However, there was no evidence as to the extent and the impact of these changes and thus it was not possible to provide an accurate quantitative estimation of the impact coming from all provisions introduced by the draft RTS. Nonetheless, the opinions of the national experts revealed that at this stage the impact would be negligible. Some of the possible impacts identified (although of unknown magnitude) are the following:

- A case where a financial institution is currently proportionally consolidated under Article 18(2) of the CRR whereas the same institution does not meet the criteria for the same treatment under the proposed draft RTS.
- Cases where proportional consolidation to joint ventures will be applicable for which the equity method is applied under IFRS 11.
- Cases where banks apply proportional consolidation of participations in institutions or financial institutions based on Article 18(5) of the CRR which was an alternative to the accounting treatment (the equity method). The proposed Article 11 of the draft RTS limits this option to certain instances and provides the national competent authorities with the discretion to require a certain method of consolidation.
- Some implications from the step-in risk assessment cannot be excluded, depending on the case-by-case assessments performed by the national competent authority. For example, the stocktaking exercise revealed a case of an institution which has a participation of approximately 40% of the capital of a financial institution and also provides guarantees to it without this involvement leading to prudential consolidation. Article 11 of the draft RTS introduces the possibility to require consolidation in such cases.

## B. Policy objectives

The high-level strategic objective of these draft RTS is to further enhance the stability of the banking system and contribute to a high, effective and consistent level of banking regulation across the EU.

Moreover these draft RTS aim at ensuring consistency in the calculation of capital requirements for EU institutions and thus enhancing the harmonisation and level playing field of the EU banking supervision.

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<sup>22</sup> 11 Member States: AT, BE, BG, DE, ES, HR, HU, IT, LU, NL, UK.



At operational level, these draft RTS aim at providing clarity to institutions regarding the application of various methods of consolidation and ensuring that the risks of the group are appropriately recognised on consolidated basis.

In addition, these draft RTS aim at allowing a certain degree of flexibility to determine the appropriate prudential treatment depending on the specific circumstances of the institutions, financial institutions and ancillary services undertakings concerned and the information provided by these undertakings to their competent authority.

### C. Baseline scenario

The current EU legislative framework (i.e. status quo without the proposed regulatory intervention) does not provide guidance on the application of different methods of consolidation and the aspects to be considered by competent authorities when deciding the appropriate prudential response to the requirements included in Article 18 of the CRR. This could lead to the application of different methods of prudential consolidation (or differences in the exclusion of entities from prudential consolidation) across institutions and member states.

### D. Options considered

In developing these draft RTS, a number of policy options has been considered regarding the following:

#### **D1. Application of the method of consolidation according to Article 22(8) and (9) of Directive 2013/34/EC (the aggregation method)**

**Option 1.1:** Including a reference to the accounting directive and avoiding providing any further guidance ('baseline scenario').

**Option 1.2:** Providing guidance on different aspects of the application of this method.

#### **D2. Introduction of the BCBS Guidelines on identification and management of step-in risk**

**Option 2.1:** No introduction of the BCBS Guidelines in the EU legal framework ('baseline scenario');

**Option 2.2:** Introduction of the BCBS Guidelines in the draft RTS;

An overview of the BCBS Guidelines is provided below.

**Option 2.3:** Introduction of some aspects of the BCBS Guidelines in the draft RTS.

### E. Cost-Benefit Analysis

#### **D1. Application of the method of consolidation according to Article 22(8) and (9) of Directive 2013/34/EC ('the aggregation method')**



**Option 1.1:** Including a reference to the accounting directive and avoiding providing any further guidance ('baseline' scenario).

Under this option, the draft RTS would only include a reference to the application of the method of consolidation according to Article 22(8) and (9) of Directive 2013/34/EC when Article 18(3) and (6) applies in line with the CRR. This implies that competent authorities and institutions would benefit from retaining the full flexibility they currently have as to the decision of the appropriate method for their jurisdiction. Also, by retaining this approach, there are no additional operational costs. On the other hand, the lack of guidance on the application of this method beyond what it is in the Accounting Directive may result in different practices across the EU and thus to increased costs of home-host cooperation.

**Option 1.2:** Providing guidance on different aspects of the application of this method.

This option involves the provision of guidance which would enhance the establishment of a level playing field amongst institutions and also contribute to a common harmonised application of the rules included in the CRR. In this regard, the draft RTS could provide some clarity in issues such as which should be the consolidating entity or the treatment of CET1, AT1 and T2 capital owned by natural or legal entities other than undertakings included in the prudential scope of consolidation. However, the application of this option may result in changes in the current prudential treatment for institutions if the application of this method is not consistent with the draft RTS. This implies some additional costs which however are negligible according to the opinions of the national experts.

#### Preferred option

The EBA considers that the best option is option 1.2 as it provides clarity on some issues where the Accounting Directive does not include guidance.

## **D2. Introduction of the BCBS Guidelines on identification and management of step-in risk**

The BCBS has published Guidelines on the identification and management of step-in risk<sup>23</sup> and their expected implementation date is no later than 2020. The BCBS Guidelines include several indicators that banks should use in identifying entities bearing step-in risk for the bank. The objective is to identify only those instances where step-in risk would significantly impact the bank's liquidity and/or capital positions. It should be mentioned though that the scope of the BCBS Guidelines is broader than the scope of these draft RTS as the draft RTS scope include institutions, financial institutions and ancillary services undertakings (when consolidated supervision is required pursuant to Article 111 of Directive 2013/36/EU), while the scope of the BCBS Guidelines includes all entities that may give rise to step-in risk.

As a next step, when the bank identifies the existence of significant step-in risk, it needs to determine appropriate measures based on the nature and extent of the anticipated step-in support

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<sup>23</sup> <https://www.bis.org/bcbs/publ/d423.htm>.



in each case. Some indicative, but not exhaustive, list of such measures may be the inclusion in the regulatory scope of consolidation, the application of a conversion factor, additional liquidity requirements, punitive ex-post capital charges, and/or large exposure-like internal limits. These measures can be applied either in isolation or in combination. Banks will need to report their self-assessment of step-in risk to the competent authority on a periodic basis.

The banks' assessment of step-in risk would be under the scrutiny of the competent authority which can take any action in case it considers that the bank has not assessed and taken the appropriate measures to address step-in risk.

When deciding on the appropriate policy option, the EBA has taken into consideration the following aspects:

- i. The BCBS Guidelines follow a Pillar II approach and provide certain flexibility on the measure to be applied (such as conversion factors or other measures). The CRR mandate is included in Article 18 of the CRR and therefore the response to step-in risk should be provided through the confines of the prudential methods of consolidation.
- ii. In the BCBS Guidelines, the assessment of 'step-in' risk is carried out by the bank and is then scrutinised by the competent authority. However, in the CRR the competent authority shall determine the appropriate method of consolidation

**Option 2.1.** No introduction of the BCBS Guidelines in the EU legal framework ('baseline' scenario)

Under this option the draft RTS would not aim to address step-in risk as in the BCBS guidelines and, therefore, the draft RTS would not include any reference to these Guidelines.

This option will not require any change to the current practices applied by the institutions and financial institutions as well as by the competent authorities, since it would not require the assessment of step-in indicators included in these draft RTS to assess the appropriateness of the method of consolidation.

On the other hand, this option would be detrimental for the level-playing field as it would not encourage the introduction of the BCBS Guidelines on step-in risk. As the step-in risk would not be recognised, the draft RTS would not address cases of implicit support through specific prudential measures even if there are indications that an institution supports an unconsolidated entity.

**Option 2.2.** Introduction of the BCBS Guidelines in the draft RTS

Under this option the draft RTS would include the content of the BCBS Guidelines as a Pillar I requirement.

According to the assessment of the EBA Staff and the relevant working group this option would be the most comprehensive as it allows the draft RTS to introduce the BCBS Guidelines in the EU legal framework and, at the same time, would contribute to the level playing field. This option would



require covering other aspects in the draft RTS than those just referring to the application of the different methods of consolidation when the step-in risk indicators are present.

This option will not provide enough flexibility to competent authorities as in certain circumstances it may be better to apply a Pillar II than Pillar I measures. The BCBS provisions for step-in risk requires the use of significant judgment and the application of an automatic Pillar I measure may not always be the best approach and may result to elevated operational costs.

**Option 2.3.** Introduction of some aspects of the BCBS Guidelines in the draft RTS

Under this option the draft RTS would include only some elements of the BCBS Guidelines. In particular it would cover those elements that can be addressed under the confines of the methods of consolidation.

This option would enforce the implementation of the BCBS Guidelines on step-in risk at EU level and at the same time would provide certain flexibility in an area that it is highly judgmental. It would also allow competent authorities to decide whether the undertakings concerned should be consolidated or it would be better to address the risk of step-in risk through other measures.

On the other side, this option will not allow full convergence of practices across institutions and Member States which implies a cost of cooperation between home-host competent authorities which follow different approaches.

**Preferred option**

The EBA considers that the preferred option is option 2.3 as it allows, to certain extent, the implementation of the BCBS Guidelines on step-in risk while still providing some flexibility to address the individualities of step-in risk in certain jurisdictions.

The draft RTS can only cover the methods of consolidation for entities under the scope of the CRR. However, to address this difference with the BCBS Guidelines, the recitals and the explanatory boxes of the draft RTS include some references for the institutions and competent authorities to consider the step-in risk under the internal capital adequacy assessment process (ICAAP) and the supervisory review and evaluation processes (SREP) as well as to enable them to assess whether additional measures are needed. In addition, in the BCBS Guidelines, the assessment on step-in risk is carried out by the bank which is then scrutinised by the competent authority. To address this difference between the BCBS Guidelines and draft RTS, the draft RTS include a reference to the need for institutions to carry-out an initial assessment of the step-in risk, when requested, which will then be considered by the competent authority.

Overall, the objective is to ensure consistency between the draft RTS and the BCBS Guidelines being mindful that the draft RTS is narrower in its scope to cover step-in risk. In this regard, it could be envisaged in the medium term to develop guidelines to implement more widely the BCBS framework on step-in risk at EU level.



**Question 9: Do you agree with the impact assessment and its conclusions? Please provide any additional information regarding the costs and benefits from the application of these draft RTS.**

**Question 10: Please provide any additional comments on the Consultation Paper.**



## 5.2 Overview of questions for consultation

**Q1.** Are there undertakings which do not comply with the definition of a financial institution or ancillary services undertaking of Regulation (EU) 575/2013 which should be included in the prudential scope of consolidation? Please explain and provide examples of these entities.

**Q2.** Do you consider SSPEs financial institutions? When SSPEs are consolidated for accounting purposes, do you also consolidate them for prudential purposes? Please differentiate in your answer between the situation when SRT is met and when it is not met (the institution originates the securitisation); and when the institution acts as an investor on the securitisation vehicle (whether this is a SSPEs or a special purpose entity used to set up securitisations) or sponsors the securitisation transaction.

**Q3.** Do you currently use the method of proportional consolidation for the consolidation of subsidiaries in accordance with Article 18(2) of Regulation (EU) No 575/2013? If proportional consolidation is used, please explain if the conditions included in Consultation Paper are met.

**Q4.** Do you have any comment on the conditions established in this Consultation Paper to apply proportional consolidation pursuant to Article 18(2) of Regulation (EU) No 575/2013?

**Q5.** Do you agree on the criteria for the determination of the consolidating entity? Do you experience a different situation currently?

**Q6.** Do you have any comment on the elements included in this Consultation Paper for the application of the 'aggregation method' pursuant to Articles 18(3) and (6)(b) of Regulation (EU) No 575/2013? Please explain.

**Q7.** Do you have any comment on the application of proportional consolidation according to Article 18(4) of Regulation (EU) No 575/2013?

**Q8.** Do you have any comment on the criteria established in this Consultation Paper on the prudential treatment of other participations or capital ties (including the equity method) under Article 18(5) of Regulation (EU) No 575/2013? Please explain.

**Q9.** Do you agree with the impact assessment and its conclusions? Please provide any additional information regarding the costs and benefits from the application of these draft RTS.

**Q10.** Please provide any additional comments on the Consultation Paper.