

EBA, EIOPA and ESMA
Joint Consultation Paper
on
Draft Regulatory Technical Standards
on the uniform conditions of application of the
calculation methods under Article 6.2 of the Financial
Conglomerates Directive
(JC/CP/2012/02)

London, Frankfurt, Paris 31. 08.2012

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I. Responding to this Consultation

EBA, EIOPA and ESMA (the ESAs) invite comments on all matters in this paper and in particular on the specific questions stated in the attached document "Overview of questions for Consultation" at the end of this paper.

Comments are most helpful if they:

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

Please send your comments to the EBA, EIOPA and ESMA by email to *joint-committee@eba.europa.eu*, *jointcommittee@eiopa.europa.eu* and *joint.committee@esma.europa.eu* by 05.10.2012, indicating the reference 'JC CP 2012 02' in the subject field. Please note that comments submitted after the deadline, or sent to another e-mail address will not be processed.

Publications of responses

All contributions received will be published on the ESAs' websites following the close of the consultation, unless you request otherwise. Please indicate clearly and prominently in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an e-mail message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with the ESAs' 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 ESAs' Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.eba.europa.eu, www.esma.europa.eu and at www.eiopa.europa.eu under the heading 'Legal Notice'.

II. Executive Summary

The CRR/CRD IV proposals¹ (the so-called Capital Requirements Regulation - henceforth 'CRR'- and the so-called Capital Requirements Directive – henceforth 'CRD') set out prudential requirements for banks and other financial institutions which are expected to apply from 1 January 2013.

In anticipation of the finalisation of the legislative texts for the CRR/CRD IV, the EBA, EIOPA and ESMA (hereafter the ESAs) through the Joint Committee, have developed the draft RTS in accordance with the mandate contained in Article 46(4) of the CRR and Article 139 of CRDIV (amending Article 21 a (2a) of the Directive 2002/87/EC) on the basis of the European Commission's proposals. This Article provides the ESAs through the Joint Committee, to develop draft Regulatory Technical Standards (RTS) with regard to the conditions of the application of the Article 6(2) of the Directive 2002/87/EC (hereafter the Directive).

Further the ESAs have developed the draft RTS having regard to Article 230 in connection with Articles 220 and 228 of the Directive 2009/138/EC². To the extent that the texts may change before their adoption, the ESAs shall adapt its draft RTS accordingly to reflect any developments. The RTS included in this consultation have to be submitted to the EU Commission by 1 January 2013.

Please note that the ESAs have developed the present draft RTS based on the European Commission's legislative proposals for the CRR/CRD IV. They have also taken into account major changes subsequently proposed by the revised texts produced by the Council of the EU and the European Parliament, during the ordinary legislative procedure (co-decision process).

Following the end of the consultation period, and to the extent that the final text of the CRR/CRDIV changes before the adoption of the RTS, the ESAs will adapt the draft RTS accordingly to reflect any developments.

Main features of the RTS

This consultation paper puts forward draft RTS in order to ensure that institutions that are part of a financial conglomerate apply the appropriate calculation

¹ Proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit
² 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II). (OJ L 335/1 as of 17 December 2009)

methods for the determination of required capital at the level of the conglomerate.

They are based in particular on the following elements:

General Principles

- Elimination of multiple gearing;
- elimination of intra-group creation of own funds;
- transferability and availability of own funds; and
- coverage of deficit at financial conglomerate level having regard to definition of cross-sector capital.

Technical calculation methods

1. Method 1: "Accounting consolidation method":

The FICOD provides in relation to Method 1 that the own funds are calculated on the basis of the consolidated position of the group.

According to this general provision, the calculation of own funds should be based on the relevant accounting framework³ for the consolidated accounts of the conglomerate applicable to the scope of the Directive.

The use of "consolidated accounts" eliminates all own funds' intra-group items, in order to avoid double counting of capital instruments. According to the Directive provisions, the eligibility rules are those included in sectoral provisions.

2. Method 2: "Deduction and aggregation method".

This method calculates the supplementary capital adequacy requirements of a conglomerate based on the accounts of solo entities. It aggregates the own funds, deducts the book value of the participations in other entities of the group and specifies treatment of the proportional share applicable to own funds and solvency requirements. All intra-group creation of own funds shall be eliminated.

³ The relevant accounting framework means the accounting rules to which the institution is subject under Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions and Council Directive (91/674/EEC) of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings.

3. Method 3: "Combination of methods 1 and 2".

The use of combination of accounting consolidation method 1 and deduction and aggregation method 2 is limited to the cases where the use of either method 1 or method 2 would not be appropriate and is subject to the permission by the competent authorities.

III. Background and rationale

The supplementary supervision of financial entities in a financial conglomerate is covered by the Financial Conglomerates Directive 2002/87/EC, hereafter known as the Directive. This Directive provides for competent authorities to be able to assess at a group-wide level the financial situation of credit institutions, insurance undertakings and investment firms which are part of a financial conglomerate, in particular as regards solvency (including the elimination of multiple gearing of own funds instruments).

The nature of RTS under EU law

Draft RTS are produced in accordance with Article 10 of the ESAs regulation⁴. According to Article 10(4) of the ESAs regulation, they shall be adopted by means of Regulations or Decisions.

According to EU law, EU regulations are binding in their entirety and directly applicable in all Member States. This means that, on the date of their entry into force, they become part of the national law of the Member States and that their implementation into national law is not only unnecessary but also prohibited by EU law, except in so far as this is expressly required by them.

Shaping these rules in the form of a Regulation would ensure a level-playing field and would facilitate the cross-border provision of services.

Background and regulatory approach followed in the draft RTS

These draft RTS are produced in accordance with CRDIV/CRR proposals, which provide that the EBA, ESMA and EIOPA (hereafter the ESAs), through the Joint Committee, shall develop draft regulatory technical standards with regard to the conditions of the application of the calculation methods with regard to Article 6(2) of the Directive and shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

⁴ 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, Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, and Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC.

The proposed draft RTS covers the uniform conditions for the use of the methods for the determination of capital adequacy of a financial conglomerate under the Directive. They elaborate on Technical principles applying to all of the three methods provided for by Directive; and also contain an Annex providing further detail for Method 2.

The requirements contained in the draft RTS are mainly directed at institutions, although some of them are directed at competent authorities.

IV. Draft Regulatory Technical Standards on the uniform conditions of application of the calculation methods under Article 6.2 of the Financial Conglomerates Directive

Structure of the draft RTS

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EUROPEAN COMMISSION

Brussels, **XXX**
[...](2012) **XXX** draft

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

of **XXX**

[...]

Commission Delegated Regulation (EU) No XX/2012

supplementing Directive xx/XX/EU [CRD] of the European Parliament and of the Council of [date], Regulation (..) No xx/XXXX [CRR] of the European Parliament and of the Council of [date] and Directive 2002/87/EC [Financial Conglomerates Directive] of the European Parliament and of the Council of [date] with regard to regulatory technical standards for the uniform conditions of application of the calculation methods under Article 6.2 of the Financial Conglomerates Directive

of XX Month 2012

THE EUROPEAN COMMISSION,

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

Having regard to the [proposal for a] Regulation (...) No xx/xxxx of the European Parliament and of the Council of dd mm yyyy on prudential requirements for credit institutions and investment firms Regulation xx/xxxx [CRR] and in particular Article 46 (4) thereof.

Having regard to the [proposal for a] Directive (...) No xx/xxxx of the European Parliament and of the Council of dd mm yyyy on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms [CRDIV] and in particular Article 139 thereof.

Having regard to the Directive 2002/87/EC, as amended, of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (hereinafter "the Directive") and in particular to Article 6(2) and Annex 1 thereof.

Whereas:

- (1) Directive 2002/87/EC provides in Chapter II, Section 2, rules on capital adequacy of financial conglomerates, such that the elements of own funds are available at the level of a Financial Conglomerates are always at least equal to the capital adequacy requirements as calculated in accordance with Annex I of the Directive.
- (2) Regulation (...) No xx/xxx ('CRR') provides in Article 46, within Part II, Chapter 2, Section 3, Sub-Section 2 and in the context of common equity

Tier I rules, requirements for deduction where consolidation or supplementary supervision are applied. This section of the CRR provides empowerments to the European Commission to adopt delegated acts (regulatory technical standards) in accordance with articles 10-14 of the Regulation (EU) No 1093/2010 establishing the European Banking Authority ('EBA'), Articles 10-14 of the Regulation (EU) No 1094/2010 establishing the European Insurance and Occupational Pensions Authority ('EIOPA'), and Articles 10-14 of the Regulation (EU) No 1095/2010 ('ESMA'), establishing the European Securities and Markets Authority. These acts will complete the EU single rulebook for institutions in the area of own funds.

- (3) Directive (...) No xx/xxx ('CRDIV') provides in Article 139 that the Directive 2002/87/EC shall be amended, such that the EBA, EIOPA and ESMA through the Joint Committee, to develop draft Regulatory Technical Standards (RTS) with regard to the conditions of the application of the Article 6(2) of the Directive.
- (4) For effective supervision of Financial Conglomerates, supplementary supervision should be applied to all such conglomerates, the cross-sectoral financial activities of which are significant, which is the case when certain thresholds are reached, no matter how they are structured. Supplementary supervision should cover all financial activities identified by the sectoral financial legislation and all entities principally engaged in such activities should be included in the scope of the supplementary supervision, including asset management companies and alternative investment fund management companies.
- (5) Without prejudice to sectoral rules, supplementary supervision of the capital adequacy rules is necessary to bring more convergence in the application of the calculation methods listed in Annex 1 of the Directive.
- (6) For financial conglomerates which include significant banking or investment business and insurance business, multiple use of elements eligible for the calculation of own funds at the level of the financial conglomerate (multiple gearing) as well as any inappropriate intra-group creation of own funds must be eliminated.
- (7) The financial conglomerate should seek an acceptable timeframe for the transferability of funds across entities within the financial conglomerate, which shall depend on whether the specific entity is subject to the Directive 2009/138/EC or the CRDIV/CRR. Moreover for an entity subject to the CRDIV/CRR this timeframe should be expediated based on the fact that due to the nature of their activities, they are more vulnerable to a rapid deterioration in confidence and/or sudden resolution situation.
- (8) In addition any non-sector-specific own funds, in excess of sectoral requirements, need to originate from entities which are not subject to transferability/availability impediments.

- (9) It is important to ensure that own funds are only included at conglomerate level if there are no impediments to the transfer of assets or repayment of liabilities across different conglomerate entities, including across sectors.
- (10) If there is a deficit of own funds at the level of the financial conglomerate, the financial conglomerate should inform the coordinator on the measures taken to cover this deficit.
- (11) Further convergence in the way that financial conglomerates apply these rules shall ensure the robust and consistent application of the methods of calculation.
- (12) For bank-led conglomerates it is necessary to apply the most prudent method of calculation for the treatment of insurance holdings to avoid regulatory arbitrage.
- (13) It is important that sector-specific own funds cannot cover risks above sectoral requirements. The financial conglomerate should first count sector-specific own funds against their requirements (while respecting sectoral rules and limits) for each relevant entity or group of entities. If there is an excess of sector-specific own funds, this should not be recognised at conglomerate level.
- (14) When calculating supplementary capital adequacy of a financial conglomerate, in respect to non-regulated financial entities within the financial conglomerate, both a notional capital requirement and a notional level of own funds should be calculated.
- (15) Under Solvency II, method 1 is applied on the basis of consolidated data which are set out at Level 2 and not on the basis of consolidated accounts.
- (16) Further changes to the capital adequacy rules may be addressed in the European Commission's review of Directive 2002/87/EC.
- (17) It is necessary that the new regime for treatment of methods of consolidation enters into force the soonest possible following the entry into force of the CRR/CRDIV and Solvency II.
- (18) This Regulation is based on the draft regulatory technical standards submitted jointly by the EBA, EIOPA and ESMA to the Commission.
- (19) The EBA, EIOPA and ESMA have conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits, in accordance with Article 10 of Regulation (EU) No 1093/2010, Article 10 of Regulation (EU) No 1094/2010, Article 10 of Regulation (EU) No 1095/2010, and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010, Insurance Stakeholder Group and the Occupational Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1094/2010, and the European Securities

and Markets Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1095/2010.

HAS ADOPTED THIS REGULATION:

TITLE I

Subject matter and definitions

Article 1

Subject matter

This Regulation lays down rules of the uniform conditions of application of the calculation methods under Article 6.2 of the Directive.

Article 2

Definitions

1. Definitions of the CRDIV/CRR, Directive 2002/87/EC and Directive 2009/138/EC shall apply to this Regulation.
2. Capital instruments are those capital instruments eligible under CRR (Regulation 2012/.../EC) and those capital instruments referred to as "own funds" in Directive 2009/138/EC.
3. Ultimate responsible entity is the entity within the financial conglomerate that is responsible for determining the capital for the financial conglomerate having regard to the following minimum criteria: control, the dominant entity from the market's perspective (market listed entity) and the ability to fulfill specific duties towards its subsidiaries and its supervisor.
4. 'indirect holding' as defined under definition 17 of Article 22 of CRR [*to be added if not in final CRR text*].

5. Insurance-led financial conglomerate is a financial conglomerate whose most important sector is insurance as defined under Article 3(2) of the Directive.
6. Bank-led financial conglomerate is a financial conglomerate whose most important sector is banking as defined under Article 3(2) of the Directive.
7. Investment firm-led financial conglomerate is a financial conglomerate whose most important sector is investment services as defined under Article 3(2) of the Directive.

TITLE II

Technical Principles

Article 3

Elimination of multiple gearing and the intra-group creation of own funds

The ultimate responsible entity shall ensure that own funds, which have been created by intra-group transactions, be it direct or indirect, shall be eliminated for the purpose of determining the required capital on a consolidated basis.

Article 4

Transferability and availability of own funds

1. For all entities of a financial conglomerate, own funds, in excess of sectoral solvency requirements, shall be considered available to absorb losses elsewhere in the financial conglomerate provided that all of the following conditions are fulfilled:
 - (a) There are no practical, legal, regulatory, contractual or statutory impediments to the transfer of funds or repayment of liabilities across conglomerate entities in due course. This is the case when the transfer of own funds from one conglomerate entity to another is not barred by a restriction of any kind and there are no claims of any kind from third parties on these assets. The ultimate responsible

entity of the financial conglomerate shall confirm to the satisfaction of the coordinator that the conditions set out in this point are met.

(b) For the purpose of assessing the transferability of funds to entities subject to 2009/138/EC, "in due course" shall mean no later than 9 months; for the purpose of assessing the transferability of funds to entities subjected to CRR, "in due course" shall mean no later than, three calendar days with no impediments on the coordinator requiring a faster transfer if necessary.

2. Own funds, in excess of sectoral solvency requirements, which do not meet the criteria under point 1 shall be excluded from the conglomerate's own funds.
3. The financial conglomerate shall demonstrate that measures have been taken to mitigate the risk that transfer of funds would have a material effect on the transferor's solvency.

EXPLANATORY TEXT for consultation purposes

This text is consistent with Annex 1 of the Directive which states "when calculating own funds at the level of the financial conglomerate, competent authorities shall also take into account the effectiveness of the transferability and availability of the own funds across the different legal entities in the group, given the objectives of the capital adequacy rules".

Point 1(a) aims to ensure that own funds are only included at conglomerate level if there are not impediments to the transfer of assets or repayment of liabilities across different conglomerate entities, including across sectors. If the conglomerate cannot confirm to the satisfaction of the coordinator that there are no inherent impediments in relation to a given entity, that entity's own funds in excess of its sectoral requirements cannot be included at conglomerate level. The impediments to be considered include practical, regulatory, contractual or statutory ones.

Point 1(b) establishes an acceptable timeframe for the transferability of funds across conglomerate entities. There is a differentiation based on the fact that entities subject to CRR, due to the nature of their activities, are more vulnerable to a rapid deterioration in confidence and/or sudden resolution situation.

Article 5

Deficit of own funds at the financial conglomerate level

1. When the difference calculated according to method 1, 2 or 3 as detailed in Annex 1 of the Directive is negative, the financial conglomerate shall ensure that the deficit is remedied with cross-sector own funds elements as defined in point 2 below.
2. When calculating own funds at the level of the financial conglomerate, cross sector own funds are elements eligible for:
 - (a) Common Equity Tier 1 in accordance with Regulation .../2012/EC [or Tier 1 Unrestricted Basic Own Funds in accordance with Directive 2009/138/EC], or
 - (b) elements that meet both sets of rules for Additional Tier 1 in accordance with Regulation .../2012/EC and Tier 1 [Restricted Basic Own Funds in accordance with Directive 2009/138/EC], or
 - (c) elements that meet both sets of rules for Tier 2 in accordance with Regulation .../2012/EC and for Tier 2 in accordance with Directive 2009/138/EC.
3. Cross-sector own funds elements mentioned in point 2 shall only be taken into account if their transferability and availability across the different legal entities in the financial conglomerate meet the conditions set out in Article 4.

EXPLANATORY TEXT for consultation purposes

The text is based on the Technical principles in Annex 1 of the Directive "Whichever method is used, when the entity is a subsidiary undertaking and has a solvency deficit, or, in the case of a non-regulated financial sector entity, a notional solvency deficit, the total solvency deficit of the subsidiary has to be taken into account. Where in this case, in the opinion of the coordinator, the responsibility of the parent undertaking owning a share of the capital is limited strictly and unambiguously to that share of the capital, the coordinator may give permission for the solvency deficit of the subsidiary undertaking to be taken into account on a proportional basis." In line with the Directive only cross-sector own funds are allowed as a remedy to a conglomerate deficit. That is, from the point at which a conglomerate deficit is observed, that shortfall amount shall be covered by the issuance of cross-sector own funds, regardless of the cause of the conglomerate deficit.

The financial conglomerate shall inform the coordinator about the deficit and the measures to cover this deficit without delay.

Article 6

Consistency

1. The Method of Calculation selected from those methods defined in Annex 1 of the Directive shall be applied in a consistent manner over time.
2. For the purpose of Article 6(2) and Annex 1 of the Directive, for a banking led conglomerate, where Article 46 (1) of the CRR is applied, the coordinator, after consulting with other competent authorities concerned, shall decide the most prudent method to be applied by the financial conglomerate.

Article 7

Consolidation

For the purpose of Art 6(2) and Annex 1 of the Directive, Method 1 of the Directive 2009/138/EC shall be considered as equivalent⁵ to the consolidation as defined under Method 1 of the Directive, for insurance-led financial conglomerate. The equivalence assessment is valid provided that the scope of the group under Solvency II is the same under the Directive or the difference in the scope is not material.

EXPLANATORY TEXT for consultation purposes

This text is based on the Directive 2009/138/EC, Article 230 in connection with Articles 220 ss. The Solvency II Implementation measures will need to be considered once they have been published. According to Directive 2009/138/EC, for the calculation of group own funds all the multiple use of eligible own funds and intra-group creation of capital should be eliminated.

⁵ This text has been based on the Solvency II Directive 2009/138/EC, Article 230 in connection with Article 220 and Article 228, and the assessment that Solvency II is equivalent.

Moreover, own funds of other financial sectors should be calculated according to the relevant sector rules.

As a result, both Method 1 of the Directive 2009/138/EC and Method 1 of the Directive are consistent with the main objectives of the supplementary supervision since they ensure that: all double-counting is removed; own funds are calculated in accordance with the definitions and limits established in the relevant sectoral rules.

The equivalence assessment is valid provided that the scope of the group under Solvency II is the same under the Directive or the difference in the scope is not material.

Article 8

Solvency requirement

1. For the purpose of the calculation of the supplementary capital adequacy requirements of the regulated entities in a financial conglomerate, a solvency requirement shall satisfy either of the points laid down in (a) and (b):
 - (a) Where the rules for the insurance sector are to be applied, solvency requirement means the Solvency Capital Requirement as defined by Article 100 or 218 of Directive 2009/138/EC as applicable, including any capital add-on applied in accordance with Articles 37, 231(7) or 232 of the same directive as applicable, and any other capital or own funds requirement applicable under Union legislation.
 - (b) Where the rules for the banking or investment services sector are to be applied, solvency requirement means the sum of own funds requirements as defined by Articles 87 to 93 of CRR, combined buffer requirements as defined by Article 122 of CRDIV, and specific own funds requirements as defined by Article 100 of [CRDIV], and any other requirement applicable under European Union law.

Article 9

The financial conglomerate's own funds and capital requirements

1. Except where expressly stated in this Regulatory Technical Standard, the financial conglomerate's own funds and capital requirements shall be calculated in accordance with the definitions and limits established in the relevant sectoral rules.
2. The own funds of asset management companies shall be calculated according to Article 2 (l) of Directive 2009/65/EC; the capital requirements are calculated according to Article 7(1) (a) of Directive 2009/65/EC.
3. The own funds of alternative investment fund managers shall be calculated according to Article 9 of Directive 2011/61/EU.

Article 10

Sector specific own funds

1. Sector specific own funds, are recognised for the coverage of risks at the sectoral level only and cannot be used to cover risks of another sector and shall not be included (above or) beyond the sectoral level. Sector specific own funds are own funds recognised under sectoral rules that do not fall within one of the following categories:

(a) Common Equity Tier 1, Additional Tier 1 and Tier 2 own funds under [CRR];

or

(b) Tier 1 unrestricted basic own funds, Tier 1 restricted basic own funds, and Tier 2 basic own funds under Directive 2009/138/EC.

2. Risks originating from the other sector shall not be covered by sector specific own funds.

EXPLANATORY TEXT for consultation purposes

Article 10 sets out that sector-specific own funds cannot cover risks above sectoral requirements. In practice, this means that, for each relevant entity or group of entities, conglomerates need to first count sector-specific own funds against their requirements (while respecting sectoral rules and limits). If there is an excess of sector-specific own funds, this shall not be recognised at conglomerate level. In addition, as stated in Article 4, any non-sector-specific own

funds in excess of sectoral requirements need to originate from entities which are not subject to transferability/availability impediments.

Article 11

Treatment of cross sector holdings for the calculation of capital requirements

Where an insurance holding of a bank-led financial conglomerate or an investment firm-led financial conglomerate is eliminated pursuant to Articles 14.3 and 14.4 or Article 15.2 or the application of these Articles as part of Method 3, no capital charge for that holding shall be applied at the financial conglomerate level for the purpose of supplementary supervision, even if a capital charge is applied at sectoral level.

EXPLANATORY TEXT for consultation purposes

At sectoral level, holdings may receive a risk weight or capital charge. At the financial conglomerate level, the same holding may be deducted or eliminated from own funds through consolidation, making the risk weight or capital charge superfluous. This capital charge shall thus not be applied for the purposes of the calculation of the conglomerates solvency requirements.

Article 12

Non-regulated financial entities

1. For a non-regulated mixed financial holding company and for a non-regulated entity held by a mixed financial holding company, the own funds and the capital requirements attributable to the non-regulated financial sector entities shall be calculated according to the most important sector in the financial conglomerate in accordance with Article 3(2) of the Directive.

2. The own funds and the solvency requirements attributable to other non-regulated financial entities shall be calculated according to the sectoral rules of the sector (insurance or banking) to which the non regulated entity is designated.

EXPLANATORY TEXT for consultation purposes

A "mixed financial holding company" is defined under Article 2(15) of the Directive.

Whichever method is used, for the purpose of the calculation of the supplementary capital adequacy of a financial conglomerate, both a notional capital requirement and notional level of own funds should be calculated for non-regulated financial entities.

These should be calculated according to the rules of the sector to which the non regulated entity belongs, or according to the most important sector in the conglomerate, having regard to Annex 1 of the Directive "In the case of a non-regulated financial sector entity, a notional solvency requirement is calculated in accordance with section II of this Annex, notional solvency requirement means the capital requirement with which such an entity would have to comply under the relevant sectoral rules as if it were a regulated entity of that particular financial sector; the notional solvency requirement of a mixed financial holding company shall be calculated according to the sectoral rules of the most important financial sector in the financial conglomerate".

Article 13

Transitional and grandfathering arrangements

The sectoral rules applied in the calculation of conglomerate own funds and solvency requirements shall take into account any transitional or grandfathering arrangements in force at sectoral level.

TITLE III

Technical calculation methods

Article 14

Method 1 Calculation criteria

1. The own funds of a financial conglomerate shall be calculated on the basis of the consolidated accounts (according to the relevant accounting framework) applied to the scope of supplementary supervision of the Directive.
2. The calculation of own funds shall take into account the removal of intra group balances, transactions and income and expenses related to the process of accounting consolidation.
3. For bank-led and investment firm-led conglomerates, unconsolidated significant investments in a financial sector entity pursuant to Article 40 of

the CRR shall be fully deducted, if the entity belongs to the insurance sector as defined in Article 2(8) of the Directive.

4. Unconsolidated non significant investments are deducted in accordance with the treatment described in Article 43 of CRR.
5. For bank-led and investment firm-led conglomerates, the sectoral treatment in Part 2, Title II of the CRR shall apply to all unconsolidated investments, participations and holdings of a conglomerate entity, provided that:
 - (a) The conglomerate entity is a credit institution or an investment firm; and
 - (b) The investment, participation or holding is in a credit institution or in an investment firm.
6. Without prejudice to points 3 and 4, any other own funds issued by one conglomerate entity and held by another, if not already eliminated in the accounting consolidation process, shall be deducted.
7. Joint controlled entities shall be treated in accordance with sectoral rules.
8. The valuation of assets and liabilities calculated for the purposes of Directive 2009/138/EC shall be used at the level of the financial conglomerate.
9. Where asset or liability values are subject to the calculation of prudential filters and deductions in accordance with those required under CRR, the asset or liability values used shall be those attributable to the relevant entities under CRR, excluding assets and liabilities attributable to other entities of the financial conglomerate. Where calculation of a threshold or limit is required in order to respect sectoral rules, the threshold or limit shall be calculated on the basis of the consolidated data of the financial conglomerate and after the removal of holdings called for by these standards.
10. Where credit institutions/investment firms and related entities are consolidated under CRR, the same entities shall be considered together.
11. Where insurance and related entities are consolidated under Directive 2009/138/EC, the same entities shall be considered together.
12. Conglomerate entities that are not consolidated under CRR or Directive 2009/138/EC shall be treated separately.
13. For the purpose of the calculation of solvency requirements, each sector shall respect the requirements as calculated under the relevant sectoral rules. When summing the relevant sectoral solvency requirements there shall be no adjustment other than as foreseen by Article 11 of Title II or as

caused by adjustments to sectoral thresholds and limits pursuant to point 9 of this Article 14.

EXPLANATORY TEXT for consultation purposes

ACCOUNTING CONSOLIDATION AND JOINT CONTROLLED ENTITIES (Points 1, 2 and 7)

Under Method 1, the Directive requires the calculation of the own funds of the conglomerate on the basis of the consolidated position of the group. In addition, any inappropriate intra-group creation of own funds must be eliminated.

In order to ensure these provisions are respected, points 1 and 2 of Article 14 requires the conglomerate to use consolidated accounts (applied to the scope of the conglomerate) as the starting point for the calculation of the own funds. In doing so, the conglomerate must allow all eliminations of own funds arising from the process of accounting consolidation to take place. Joint-controlled entities are to be proportionally consolidated in line with point 6.

OTHER INTRA-GROUP CREATION OF OWN FUNDS (Point 6)

In line with the Directive's principles, Article 3 of this Regulation calls for the elimination of all own funds that have been created by intra-group transactions, be it direct or indirect. For the avoidance of doubt in the context of Method 1, point 5 further specifies that all intra-group creation of own funds should be eliminated on top of accounting consolidation, if not already eliminated as part of the accounting consolidation process. Such additional elimination may be required in particular where the treatment of the participation called for by the Directive is different from that provided for by accounting rules, considered that accounting rules doesn't consider the multiple gearing issue.

CROSS SECTOR HOLDINGS AND OTHER HOLDINGS (Points 3, 4 and 5)

For bank-led and investment firm-led conglomerates, the calculation of own funds at the level of the conglomerate should also take into account that the sectoral rules allow institutions to risk weight and not deduct some cross-sector holdings. For this reason, in order to ensure the elimination of multiple gearing at the level of conglomerate, point 3 of Article 14 requires the deduction of holdings that are neither consolidated nor eliminated (by

deduction) at sectoral level, where those holdings are in entities belonging to the insurance sector. Point 4 describes the treatment of unconsolidated non significant investment holdings where those holdings are in entities belonging to insurance entities. Point 5 describes the treatment of other holdings, specifying that other holdings are treated according to sectoral rules (see the table in Annex II).

SOLVENCY 2 VALUATION CRITERIA (Points 8)

For insurance parts of the conglomerate, given that Article 75 of Directive 2009/138/EU sets out specific valuation rules for assets and liabilities, point 8 of Article 14 specifies that assets and liabilities for those entities within the conglomerate should follow the valuations calculated for the purpose of Directive 2009/138/EU. This point is aimed at ensuring that the calculation of the elements of own funds at the level of conglomerate is consistent with sectoral rules.

RECALCULATION OF LIMITS AND THRESHOLDS, TAKING INTO ACCOUNT REMOVAL OF HOLDINGS (Points 9)

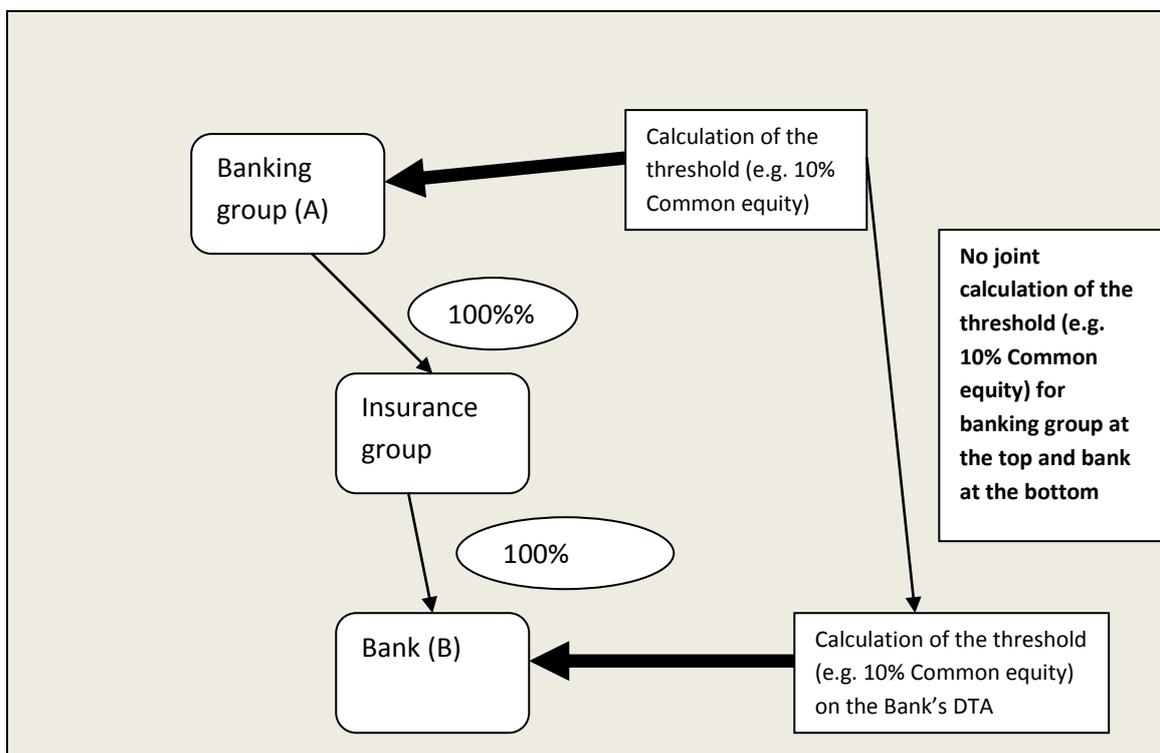
Once the accounting consolidation has been carried out, as well as the other provisions already mentioned, amounts of CET1 attributable to conglomerate entities that are subject to CRR at sectoral level, as well as amounts of holdings belonging to such entities that are neither deducted nor consolidated, will change. So the calculations based on CET1 in Article 45 of CRR, which measure the threshold for the deduction of deferred tax assets and significant investments, should be recalculated. The recalculation should take into account the effect on CET1 of the conglomerate accounting consolidation process, proportional consolidation in accordance with point 7, the removal of holdings in point 3, and any other factors stemming from the conglomerate calculation that have led to a change in CET1 .

In the calculation according to Article 45 of CRR for an entity or group of entities, the deferred tax assets and significant investments to be taken into account are only those belonging to that entity or group of entities within the conglomerate.

These rules are provided for in point 9.

MULTI-LAYER CONGLOMERATES (Points 10, 11 and 12)

This Regulation recognises that financial conglomerate structures may be very complex and involve different layers (see graph example below).



In cases like this, where a banking group controls an insurance group, which – in turn – controls a bank, in order to calculate the limits or thresholds provided at sectoral level, the data of the banking group at the top of the group shall not be calculated jointly with the data belonging to the bank (B) controlled by the insurance group. In this case, bank (B) calculates a threshold on its Deferred Tax Assets.

Bearing in mind that the Directive states the elements eligible for the calculation of the own funds are those that qualify in accordance with the relevant sectoral rules, point 10 calls for the relevant groupings at sectoral level to be maintained also at the conglomerate level for the purposes of calculating limits and thresholds.

SOLVENCY REQUIREMENTS (Point 13)

Finally, point 13 specifies that the calculation of solvency requirements is based on the sum of sectoral and notional requirements, except for the provision included in Article 11 (no capital charge for holdings that are consolidated or deducted at the conglomerate level).

See also the Annex - Summary of the treatment of holdings and participations for the purpose of the calculation of the own funds of the conglomerate.

Article 15

Method 2 Calculation criteria

1. For the purpose of calculating Method 2 as set out in Annex I part II of the Directive:
 - (a) the proportional share applicable to own funds and solvency requirements shall relate to the proportion of the subscribed capital which is directly or indirectly held by the parent undertaking or undertaking which holds a participation in another entity of the group;
 - (b) the book value of participations in other entities of the group shall be the book accounting value for the parent undertaking or for the undertaking that holds a participation in another entity of the group;
 - (c) Where the own funds of a holding is subject to a prudential filter, the filtered amounts shall be:
 - i) added to the book value mentioned in b), if the filtered amount increases regulatory capital; or
 - ii) deducted from the book value mentioned in b), if filtered amount decreases regulatory capital.
 - (d) For the purpose of point (c), the filtered amounts pertains to the net amount affecting own funds of the holding.
2. For bank-led and investment firm-led conglomerates, significant investments in a financial sector entity pursuant to Article 40 of the CRR, if the entity belongs to the insurance sector as defined in Article 2(8) of the Directive, shall be:
 - (a) fully deducted, where the holding is not a participation as defined in Article 2(11) of the Directive, and
 - (b) treated according to Method 2, where the holding is a participation as defined in Article 2(11).
3. For insurance-led conglomerates, participation as defined in Article 2(11) of the Directive shall be considered for the application of point 1.
4. For the purpose of the first point, to eliminate the intra-group creation of own funds, the eligible amount of intra-group investments in any capital instruments that are eligible as regulatory capital, respecting relevant sectoral limits, shall be eliminated.

EXPLANATORY TEXT for consultation purposes

Point 1(c) addresses cases where prudential filters affect the own funds of a participation for prudential purposes by adding back unrealised losses or subtracting unrealised gains, for example in the case of a holding held in the Available For Sale category. If this is the case, the effect of the prudential filter should be reversed [by adjusting the book value of the participation to be deducted]. Without this reversal the filtering of unrealised gains would unduly reduce own funds after deduction of accounting book value, while the filtering of unrealised losses would unduly flatter own funds after the deduction of accounting book value.

Referring to the formula in the Annex: if, because of the application of a prudential filter the Own Funds term $x_i(\mathbf{OF}_i - \text{REQ}_i)$ changes, then its effect should be neutralized by an offsetting adjustment in the book value term: BV_i .

See also the Annex - Summary of the treatment of holdings and participations for the purpose of the calculation of the own funds of the conglomerate.

Article 16

Method 3 Calculation criteria

1. The competent authorities may permit the financial conglomerate to use a combination of methods 1 and 2, only where the financial conglomerate can demonstrate to the competent authorities that its request has been made:
 - (a) further to its best effort to apply either, Methods 1 or 2; and
 - (b) having regard to the cases in Article 6 (5) of the Directive.
2. If several entities are collectively of non negligible interest, the competent authorities shall take this into account in assessing the request to use Method 3.
3. The application of the specific combination of Methods 1 and 2 to entities within the financial conglomerate that was permitted by competent authorities shall be applied in a consistent manner over time.
4. The coordinator shall consult the other relevant competent authorities before taking a decision on whether to permit the use of the combination of methods 1 and 2.

EXPLANATORY TEXT for consultation purposes

Article 6 (5) (a) (b) and (c) of the Directive states:

“(a) if the entity is situated in a third country where there are legal impediments to the transfer of the necessary information, without prejudice to the sectoral rules regarding the obligation of competent authorities to refuse authorisation where the effective exercise of their supervisory functions is prevented;

(b) if the entity is of negligible interest with respect to the objectives of the supplementary supervision of regulated entities in a financial conglomerate;

(c) if the inclusion of the entity would be inappropriate or misleading with respect to the objectives of supplementary supervision.

However, if several entities are to be excluded pursuant to (b) of the first subparagraph, they must nevertheless be included when collectively they are of non-negligible interest.”

TITLE IV

Final provisions

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]

ANNEX I

Calculation methodology for Method 2 – Deduction and aggregation method

1. General principles

The calculation of method 2 shall be carried out on the basis of the regulatory reporting required under the applicable accounting framework of each of the entities in the group following the formulaic expression below:

$$scar = \sum_i^G x_i (OF_i - REQ_i) - \sum_i^G (BV_i)$$
$$scar \geq 0$$

where own funds (OF_i) exclude intra-group capital instruments.

The supplementary capital adequacy requirements ($scar$) shall thus be calculated as the difference between:

(1) the sum of the own funds (OF_i) of each regulated and non-regulated financial sector entity (i) in the financial conglomerate; the elements eligible are those which qualify in accordance with the relevant sectoral rules; and

(2) the sum of the solvency requirements (REQ_i) for each regulated and non-regulated financial sector entity (i) in the group (G); the solvency requirements shall be calculated in accordance with the relevant sectoral rules; and the book value (BV_i) of the participations in other entities (i) of the group.

In the case of non-regulated financial sector entities, a notional solvency requirement shall be calculated according to Article 11. Own funds and solvency requirements shall be taken into account for their proportional share (x) as provided for in Article 6(4) and in accordance with Annex I. The difference shall not be negative.

ANNEX II- Summary of the treatment of holdings and participations for the purpose of the calculation of the own funds of the conglomerate

Panel A: Treatment of holdings in the case where a credit institution owns an insurer or credit institution.				
Method 1				
Percentage held by the Financial Conglomerate :	$x < 10\%$, no significant investment	$10\% \leq x \leq 20\%$, Significant investment (Article 40 of CRR)	$20\% \leq x \leq 50\%$ or participation (Article 2.11 of 2002/87/EC)	Control ($50\% \leq x \leq 100\%$ or dominant influence)
Bank owns insurer	Article 43 CRR (Article 14.4 of the RTS)	Deduction (Article 14.3 of the RTS)	Deduction (Article 14.3)	Full consolidation
Bank owns bank	Article 43 CRR	Threshold treatment (Article 14.5 of the RTS)	Threshold treatment (if using equity method: (Article 14.5 of the RTS) or proportional consolidation	Full consolidation
Method 2				
	$x < 10\%$, no significant investment	$10\% \leq x \leq 20\%$, Significant investment (Article 40 of CRR)	$20\% \leq x \leq 50\%$ or participation (Article 2.11 of 2002/87/EC)	Control ($50\% \leq x \leq 100\%$ or dominant influence)
Bank owns insurer	Article 43 CRR	Deduction (Article 15.2(a) of the RTS)	Deduction and aggregation. (Deduct Book Value) (Article 15.2(b) of the RTS)	Deduction and aggregation. (Deduct Book Value)
Bank owns bank	Article 43 CRR	Threshold treatment	Deduction and aggregation. (Deduct Book Value)	Deduction and aggregation. (Deduct Book Value)

Panel B: Treatment of holdings in the case when an insurer owns an insurer or credit institution.
Method 1
Solvency II equivalence applies: Solvency 2 implementing measures will need to be considered once they have been published.
Method 2
No additional detail needed in RTS, because Solvency II does not have a concept of significant investments at 10%, only the concept of participation ($\geq 20\%$) and significant influence. Participations are already covered by the RTS text on Method 2.

V. Accompanying documents

a. Draft Cost- Benefit Analysis / Impact Assessment

1. Introduction

According to CRDIV/CRR proposals, the EBA, EIOPA and ESMA (hereafter the ESAs) through the Joint Committee, shall develop draft regulatory technical standards with regard to the conditions of the application of the Article 6(2) of the Directive, and shall submit those draft regulatory technical standards to the Commission by 1 January 2013.

The Technical Standard describes how institutions following the consolidation methods set out in this Directive shall calculate own funds in the parent institution in a financial conglomerate. The standard introduces restrictions on which elements of own funds in subsidiaries and other participated entities of a financial conglomerate can be used in the calculation of own funds. The main rationale underpinning this Technical Standard is to avoid an “inflated” calculation of own funds of cross-sector financial conglomerates.

This Technical Standard focuses on harmonising the calculation of financial conglomerates’ own funds.

2. Problem definition

A lesson learned from recent financial crises is that the regulation of supplementary supervision, in particular the current set of rules on determining own funds at the conglomerate level, deserves a thorough rethink. For example, in the recent past it became clear that parent institutions could report strong levels of own funds, giving an impression of a robust solvency. In some cases that impression turned out to be misleading as significant amounts of own funds were, in practice, locked-in in the subsidiaries. This consequently rendered the Directive’s assumption of availability of funds at the conglomerate level rather uncertain - because of a lack of harmonisation of rules on conglomerate own funds.

This affects the ability of conglomerates’ own funds to absorb losses, which makes financial conglomerates more fragile than figures on own funds would suggest.

Multiple gearing

Uncertainties in the application of the methods for determining own funds at the conglomerate level may have led to undesirable levels of multiple gearing. This Technical Standard therefore builds upon the Directive and contributes to achieving its objective to eliminate the multiple use of elements eligible for the calculation of own funds at the level of the financial conglomerate (see for example Recital 7, Article 31 point 2, and Annex I, section I of the Directive).

Methods to determine Own funds at the Financial Conglomerate Level.

Uncertainties in the guidance about the choice of methods for determining own funds at the conglomerate level may have led to an arbitrary combination of the methods that are offered under Annex I of the Directive. This Technical Standard therefore provides additional clarity on the calculation methods for conglomerate own funds.

3. Objectives of the Technical Standard

The objective of this Technical Standard is to achieve a more consistent harmonisation of the calculation methods of Own Funds listed in Annex I of Directive.

This should translate in increased efficiency and effectiveness of conglomerate supervision by competent authorities, more clarity on the availability and transferability of own funds for the conglomerate, as well as tightly controlled levels of multiple gearing.

4. Options

Annex I of the Directive, describes three methods to calculate a conglomerate's own funds. This Technical Standard concentrates on the application of these methods.

There is not a wide selection of options available for this Technical Standard. Any choice made with respect to this Technical Standard derives from the text of relevant Directives, predominantly the sectoral directives, CRR/CRD4 and Solvency II.

The guiding principles used by this Technical Standard to achieve more consistent harmonisation of calculation methods mentioned in Annex I of the Directive are:

1. To offer clarity in rules regarding transferability and availability of conglomerate own funds,
2. To eliminate the multiple use of elements eligible for the calculation of own funds at the level of the financial conglomerate,
3. To avoid double deduction of items and amounts from own funds, and
4. To respect sectoral rules.

Method 1

Method 1 is based on consolidated position of the conglomerate in order to avoid multiple gearing. For this purpose, the RTS requires the elimination of all intra-group creation of own funds; the scope of the group is defined according to article 2, point 12 of the Directive. Adjustments are required to sectoral rules in the treatment of banking cross holdings and some instructions not included in the Directive are provided for unregulated entities. According to the Directive provisions, the capital requirements are calculated as sum of sectoral requirements without the elimination of intra-group transactions.

Method 2

The description of this method in its current form is already quite prescriptive and unambiguous. However, this Technical Standard elaborates on two issues that may lead to disharmonised interpretations:

- i. The proportional share applicable to own funds and solvency requirements;
- ii. The interpretation of the book value of participations in other entities of the group.

With respect to the latter issue, this Technical Standard uses the book value from the accounts of the parent as a starting point, but applies adjustments to any book values subjected to prudential filters in order to safeguard consistency in the calculation of this method's deduction of book value.

The method requires, according to the general principle of avoiding inappropriate creation of intra-group own funds, the deductions of all the intra-group investments in capital instruments eligible according to sectoral rules. This provision ensure also an equivalence between this method of calculation of the own funds and the others allowed according to the Directive.

Method 3

The use of combination of methods 1 and 2 is limited only to the cases where the use of either method 1 or method 2 solely would not be appropriate due, for example, to the lack of information on specific entities within the group. The use of method 3 shall need the permission of the competent authorities or the coordinator after consultation of the relevant other competent authorities. The combination method 3 shall be applied in a consistent manner over time. The supervisory consent is needed in order to prevent regulatory arbitrage.

5. Impacts

This technical standard's objective is to achieve a more consistent harmonization of the methods mentioned in Annex I of the Directive. This may limit the degree of freedom with respect to the ways of calculating own funds of conglomerates.

The expected impact compared to the sectoral rules for insurance-led conglomerate that apply method 1 of the Directive, where the scope of the insurance group under Solvency II is not the same as the financial conglomerate under the Directive (see Article 7), is due mainly to the line by line consolidation of the items of the banking subsidiaries and banking joint controlled entities instead of the consolidation procedures provided under the Solvency 2 framework. In the case the scope is the same or difference is not material, insurance-led conglomerate applies Solvency 2 rules as they will be defined in the implementing measures Solvency 2.

For banking-led and investment firm-led conglomerate the main expected impact compared to the sectoral rules is due to the consolidation of the insurance subsidiaries and joint controlled insurance entities that are risk weighted or deducted according to CRR.

Both insurance and banking group shall also adjust, where applicable, the amount of the threshold and parameters used for their eligibility limits (for example, thresholds on Deferred Tax Assets and on deduction of holdings under Article 45 of CRR), considering the effect of the consolidation of cross sector holdings at conglomerate level.

Insurance, bank and investment firm-led conglomerates shall take into account of limits to transferability and availability of own funds as foreseen in the Technical Standard.

A cost factor relates to the alignment of the entities to the requirements of this Technical Standard. Such costs may arise if current national regulations need to be amended to comply with the Technical Standard.

Another cost factor may arise in the cases where competent authorities are called upon to approve the use of Method 3.

Lastly, this Technical Standard may also affect the business model for a group to organize itself as a financial conglomerate.

There are a number of expected benefits related to this Technical Standard. They are:-

- i. More consistency in the selection and application of the methods of Annex I of the Directive;
- ii. Increased efficiency and effectiveness of conglomerate supervision;
- iii. More clarity on the amount, availability, and transferability of own funds within a financial conglomerate;
- iv. More effective loss absorption of the capital held by conglomerates;
- v. An increased standardization of the use of the methods, leading to lower costs of their application; and
- vi. A contribution to greater financial stability.

b. Overview of questions for Consultation

1. What are the cost implications of a requirement for conglomerates to follow the clarifications for calculating own funds and solvency requirements described in this paper? If possible, please provide estimates of incremental compliance cost that may arise from the requirements, relative to following the Directive in the absence of the Regulatory Technical Standards.
2. How, in your opinion would the proposed clarifications impact on conglomerates' business models?
3. How far would the suggested clarifications change current market practices?
4. Are the Technical Principles in Title II sufficiently clear? If not, what areas require further clarification?
5. Are there any areas of ambiguity in the way that the Technical Principles in Title II apply to the three consolidation methods?
6. Are there any areas of ambiguity in the way that Method 1 needs to be carried out?
7. How much of an operational burden is the use of consolidated accounts of the conglomerate as a starting point for Method 1? Is there an alternative more straightforward method/way to eliminate the intra-group creation of own funds?
8. Do you foresee any problems in applying sectoral rules to own funds under Method 1? If so, what refinements to the method would you propose?
9. Are there any areas of ambiguity in the way that Method 2 needs to be carried out?
10. For the purpose of assessing the transferability of "funds" to entities subject to CRR, under Article 4, is "three calendar days" a sufficient timeframe in a period of stress?