

In case of discrepancies between the French and the English texts, the French text shall prevail.

Luxembourg, 20 December 2000

To all investment firms

**Circular CSSF 00/22**

**Re: Supervision of investment firms on a consolidated basis by the Commission de Surveillance du Secteur Financier**

Ladies and Gentlemen,

The Law of 29 April 1999 published in Mémorial A No. 53 of 12 May 1999 transposes into Luxembourg law part of Article 7 of Council Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investment firms and credit institutions. It amends the Law of 5 April 1993 on the financial sector by inserting a new Chapter 3a in Part III which has the following title: "Supervision of investment firms on a consolidated basis" the content of which includes Articles 51-2 to 51-8. In what follows, reference is made to the articles of the Law of 5 April 1993 on the financial sector, as amended by the Law of 29 April 1999.

The purpose of this circular is to specify, for the investment firms falling within its scope of application, the practical implications of the new rules for the supervision on a consolidated basis.

In this context, please note that this circular only applies to investment firms, i.e. companies falling within the scope of Article 24 of the amended Law of 5 April 1993, namely commission agents, private portfolio managers, professionals acting for their own account, distributors of units/shares in UCIs and underwriters.

It is not aimed at branches of investment firms or investment firms which do not hold or do not intend to hold direct or indirect holdings in other investment firms, financial institutions or credit institutions or investment firms which do not belong to groups dominated by a financial company or mixed-activity company.

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## **I. PURPOSE AND APPROACH OF THE NEW LAW**

The prudential supervision of investment firms on a consolidated basis has been established by the Community Directive 93/6 of 15 March 1993 transposed into Luxembourg law by the Law of 29 April 1999.

Before the Law of 29 April 1999 entered into force, there was no legal obligation for investment firms to be subject to supervision on a consolidated basis in the same way as to supervision on an individual basis. Council Directive 92/30/EEC of 6 April 1992 on the supervision of credit institutions on a consolidated basis transposed into Luxembourg law by the Law of 3 May 1994 does not apply to groups which do not include a credit institution.

It is worth reminding at this stage, a fundamental distinction to be drawn between, on the one hand, the consolidation for the purposes of the institution and the publication of the consolidated accounts, governed by the Law of 11 July 1988 amending the Law of 10 August 1915 on commercial companies, as amended, and, on the other hand, the consolidation for the purposes of the prudential supervision exercised by the CSSF in accordance with the new Articles 51-3 to 51-7 of the Law of 5 April 1993 on the financial sector, as amended, and with this circular.

Thus, the supervision on a consolidated basis, aimed to assess the risks of a (banking or) financial group, only concerns holdings in investment firms, credit institutions or financial institutions whereas the preparation of consolidated accounts, which aims to inform the public of the financial information on a group of undertakings, concerns, in principle, all banking/financial holdings and others. Given the difference in objectives and scope of application, the investment firms which are exempted, under the Law of 11 July 1988, to provide consolidated accounts to be published, are nevertheless required, pursuant to the new Articles 51-3, 51-7 and 51-8, to prepare consolidated accounts for prudential supervisory purposes if they are subject to the consolidated supervision of the CSSF.

For the purposes of this circular, the States that are contracting parties to the European Economic Area Agreement other than the Member States of the European Union are considered as equivalent to Member States of the European Union, within the limits set forth by this agreement and related acts.

## **II. PRINCIPLES OF PRACTICAL APPLICATION OF THE SUPERVISION ON A CONSOLIDATED BASIS**

The investment firms falling within the scope of application of the supervision on a consolidated basis are required to identify the scope of consolidation and to determine the method of consolidation by applying the principles as detailed below. The

groups so defined are required to comply with the provisions on the content of the consolidated supervision.

For the purposes of this chapter, reference should be made to the Annex of the circular which lists the definitions of a certain number of terms used repeatedly and included in Chapter 3a of Part III of the Law of 5 April 1993 on the financial sector, as amended. It should be noted that some definitions are different than those used in the framework of Chapter 3 of Part III of the above-mentioned law and Circular IML 96/125 published pursuant to the Law of 24 May 1994 on the consolidated control of credit institutions.

## **A. CASE OF GROUPS WHICH INCLUDE INVESTMENT FIRMS, EXCEPT CREDIT INSTITUTIONS (51-3 TO 51-6)**

### **1. Scope of application of the supervision on a consolidated basis**

#### **1.1 Case of a consolidating investment firm**

The investment firms authorised in Luxembourg which have as subsidiaries, in Luxembourg or abroad (EC Member States and third countries) at least one investment firm or financial institution or which have a holding in such institutions are subject to the supervision on a consolidated basis by the CSSF. The investment firms which have as subsidiary a credit institution are dealt with in Chapter B of this circular.

The investment firms authorised in Luxembourg cannot benefit from an exemption from the consolidated supervision to be exercised by the CSSF by the mere fact that they are themselves subsidiaries of an investment firm supervised by a supervisory authority of another EC Member State.

#### **1.2 Case of a consolidating Luxembourg financial company**

The investment firms authorised in Luxembourg which are subsidiaries of a parent company established in Luxembourg, which is a financial company pursuant to Article 51-2, 3rd indent, i.e. a financial institution whose subsidiary/subsidiaries is/are exclusively or mainly one or more investment firm(s) or financial institution(s), at least one of these subsidiaries being an investment firm, are also subject to the supervision on a consolidated basis by the CSSF. The other professionals of the financial sector which are not investment firms and the holding companies having exclusively or mainly holdings in investment firms also fall within this category.

In these cases, the Luxembourg investment firm is subject to a consolidated supervision based on the consolidated situation of the financial company, without the individual financial company being necessarily subject to the supervision of the CSSF.

Where the Luxembourg financial company being a shareholder of the Luxembourg investment firm, is itself held by an investment firm having its registered office in another EC Member State and insofar as the Luxembourg investment firm has no subsidiary or does not have holdings as those referred to in point 1.1. above, the supervision on a consolidated basis is exercised by the supervisory authorities competent for the supervision of the investment firm which is shareholder of the Luxembourg financial company and not by the CSSF. If, however, the Luxembourg investment firm has one or several subsidiaries or has holdings to be consolidated, the CSSF exercises the consolidated supervision downstream of the Luxembourg investment firm pursuant to the provisions of point 1.1. above.

Where a Luxembourg financial company has subsidiary investment firms in several EU Member States but not in Luxembourg, the CSSF and the relevant supervisory authorities agree to designate the one which will be in charge of the consolidated supervision. The CSSF is willing, where appropriate, to assume responsibility for a consolidated supervision provided that it also supervises, on a stand-alone basis, the Luxembourg financial company in accordance with the Law of 5 April 1993 on the financial sector, as amended, (which is not the case for holding companies). In the absence of an agreement between the authorities of the countries where the subsidiaries are established, the consolidated supervision is assumed by the authority having given the authorisation to the investment firm with the largest balance sheet total or which, on equal balance sheet total, is the oldest.

### 1.3. Case of a consolidating Community financial company

Where a Luxembourg investment firm is a subsidiary of a financial company established in another EC Member State and this financial company has no other subsidiary investment firm in the EC, the CSSF exercises the consolidated supervision based on the consolidated situation of the financial company.

Where the financial company which is the parent undertaking of the Luxembourg investment firm has also a subsidiary investment firm in the EC Member State in which it is established, the supervisory authorities of this State are competent for the exercise of the supervision on a consolidated basis.

Where this financial company which is the parent undertaking of an investment firm governed by Luxembourg law has no subsidiary in the Member State in which it is established, but one or several subsidiary investment firms in one or several other EC State(s), the CSSF and the relevant supervisory authorities agree to designate the one in charge of the consolidated supervision. In the absence of an agreement between the authorities of the countries where the subsidiary investment firms are established, Article 51-3(2)(c) of the Law of 5 April 1993 on the financial sector, as amended, provides that the CSSF assumes the supervision on a consolidated basis if the subsidiary

investment firm authorised in Luxembourg has the largest balance sheet total or which, on equal balance sheet total, is the oldest investment firm of the group.

If the financial company, shareholder of the investment firm governed by Luxembourg law, is itself held by an investment firm having its registered office in another EU Member State, the provisions of the third subparagraph of point 1.2. above are applicable.

#### 1.4. Case of a consolidating non-Community financial company

In case of financial groups which have an investment firm in Luxembourg but whose group head is located outside the EC, the responsibility of the supervision on a consolidated basis of the subgroup of the undertakings, for which the supervisory authorities of an EC Member State is competent, is determined at the highest level on the EC territory. The authorities responsible for this supervision are determined by applying the principles set out below.

Where the financial company, established on non-Community territory, is the parent undertaking of a Luxembourg investment firm, and where the group does not have an investment firm in another EC Member State, the CSSF exercises the consolidated supervision downstream of the Luxembourg investment firm in accordance with the provisions of point 1.1. above.

Where this financial company has moreover one or several subsidiary investment firms in one or several other EC States, the CSSF and the relevant authorities designate, by mutual agreement, the subsidiary in charge of the consolidated supervision. In the absence of an agreement, the provisions of Article 51-3(2)(c) are applicable (cf. point 1.3. above).

If the financial company, shareholder of the Luxembourg investment firm, is itself held by an investment firm having its registered office in another EC Member State, reference should be made to the provisions of the third subparagraph of point 1.2. above.

## **2. Scope of the supervision on a consolidated basis**

### 2.1. General principle

#### 2.1.a. Types of companies concerned

The scope of the supervision on a consolidated basis, which is not limited to the EC territory, covers investment firms and financial institutions.

The following entities are considered as investment firms:

- all legal persons governed by Luxembourg law which carry on a business activity which consists of providing investment services to third parties. "Investment service" means any service provided to third parties which is included in Section A of Annexe II of the Law of 5 April 1993 on the financial sector, as amended, and which concerns one of the instruments listed in Section B of Annexe II of the aforementioned law.

"Financial institution" means according to this regulation, any undertaking other than a credit institution or an investment firm, the principal activity of which is to acquire holdings or to carry on one or more of the activities listed in points 2 to 12 of Annexe I to the Law of 5 April 1993 on the financial sector, as amended.

The scope of consolidation covers, but is not limited to, the following entities:

- the holding companies regardless of the composition of their portfolio of holdings (subject to point 2.1.c.), as the scope of consolidation is not limited to holding companies with financial holdings;
- the other professionals of the financial sector as defined in Chapter 2 of Part I of the Law of 5 April 1993 on the financial sector, as amended;
- the management companies of one or several investment funds;
- the investment companies with variable capital;
- the leasing companies (mainly carrying out property leasing transactions).

#### 2.1.b. Particular cases of ancillary banking services undertakings

The consolidated supervision also extends to ancillary banking services undertakings provided that the supervision on a consolidated basis is mandatory due to the fact that the investment firm of its parent undertaking has subsidiaries or holdings in investment firms or financial institutions. However, where the ancillary banking services undertakings are the only companies to be consolidated which depend on the investment firm, they do not trigger a consolidated supervision.

#### 2.1.c. Consolidation threshold

The companies referred to in points 2.1.a. and 2.1.b. must be included in the scope where they are subsidiaries or sub-subsidiaries of the investment firm falling within the scope of application or of its parent undertaking which is a financial company in the cases referred to in points 1.2., 1.3. and 1.4. above. Indeed, the subsidiary of a subsidiary is also considered as a subsidiary. Moreover, any company referred to in points 2.1.a. and 2.1.b. in which a participation, equal to or higher than 20% of the voting rights or of the capital, is directly or indirectly held, falls within the scope of the consolidated supervision.

In case of holdings other than those defined in Article 48, 6th indent, or even in the absence of any holdings or capital ties, a consolidation may be required pursuant to Article 51-4(4) if an investment firm exercises significant influence on one or several

investment firms or financial institutions. The relevant institutions provide the CSSF with a description of the consolidation methods they intend to apply. The CSSF determines whether and in what form a consolidation must be carried out. The same applies in the case where two or more investment firms or financial institutions are placed under a single management or have administration, management or supervisory bodies consisting, for the major part, of the same persons.

## 2.2. Case of waiver

The law allows the CSSF to waive its right to include in the scope of the supervision on a consolidated basis, given entities where the conditions mentioned in Article 51-3(4) are complied with.

It should be noted from the outset that, even if the law offers the possibility not to include in the supervision on a consolidated basis, entities for which there are legal obstacles to the transfer of the information necessary for the exercise of this supervision, the CSSF does not, in principle, envisage making use of it. In practice, the case of waiver for this reason should not occur as it would mean that the interest itself of the parent undertaking is affected: the CSSF considers indeed that the latter must have, at any time, means enabling to have sufficient influence on the transactions carried out and the risks incurred by the entity in which it has holdings. The information necessary to enable the supervision on a consolidated basis to be exercised by the CSSF will be thus available.

In accordance with the provisions of Article 51-3(4), 2nd and 3rd indents, the CSSF waives, however, the supervision on a consolidated basis in the cases where the inclusion in the consolidation of companies in which a participation is held would be of negligible interest with respect to the objectives of the supervision of the investment firms or would be inappropriate due to the nature of the undertaken activities.

However, a consolidation should be carried out if the consolidating undertaking holds several participations which, taken on a stand-alone basis, are of negligible interest, but whose total of individual balance sheets exceeds the criteria set, i.e. EUR 10 million or 1% of the balance sheet total of the parent undertaking or the undertaking that holds the participation, and insofar as the group of companies is not of negligible interest with respect to the aforementioned objectives.

It is clear that a waiver on the basis of Article 51-3(4) will only be valid as long as the grounds on which it is based remain the same. The undertaking falling within the scope of application is required to inform the CSSF in case of change of the objective pursued by the acquisition of a holding or in case of overrun of the lowest of the two thresholds provided for in the law, i.e. EUR 10 million or 1% of the balance sheet total of the parent undertaking or the undertaking that holds the participation. The CSSF will verify whether the waiver can be maintained or not.

The Law of 29 April 1999 provides for a new case of waiver which is not included in the Law of 3 May 1994 for the supervision of credit institutions on a consolidated basis. The CSSF may waive, if the circumstances so warrant, the supervision of investment firms on a consolidated basis, provided that every investment firm, whether it is of Community or non-Community origin, likely to be included in the scope of supervision on a consolidated basis by the CSSF, complies with the conditions listed in Article 51-3(5). The purpose of these conditions is to ensure in another manner the supervision of all the risks of the group.

The undertakings which would like to benefit from this case of waiver must make a justified request to the CSSF and specify:

- the circumstances on which this request is based and which would justify the waiver of the CSSF's consolidated supervision, and
- the manner in which the aforementioned conditions are complied with.

The application of these cases of waiver by the CSSF, does not prejudice the obligation of the investment firms to provide information on the companies excluded from the consolidation on the basis of the provisions of Article 51-3(4), 2nd and 3rd indents and Article 51-3(5).

### **3. Methods of consolidation**

#### 3.1. Full consolidation

Pursuant to Article 51-4(1), the CSSF exercises its supervision on the basis of a full consolidation in case of a holding equal to or higher than 50%. The full consolidation is also applied in the cases of an effective control or dominant influence, even if the consolidating undertaking does not hold a share of capital equal to or higher than 50%. A situation of effective supervision is deemed to be established either when the parent undertaking holds, directly or indirectly, the majority of the voting rights or when the parent undertaking is entitled to appoint the majority of the members of the administration or management bodies, or when there is no other majority shareholder or shareholder with substantial holding or when the parent undertaking holds *de facto* a majority in accordance with an agreement concluded with other shareholders or members of the undertaking, or when there are historical ties with the parent undertaking. A situation of dominant influence is deemed to exist in the case where a dominant company has the means which enable it to submit the dominated company to its will and to impose its will on it. In principle, this domination is exercised by means of a contract or pursuant to a clause in the articles of incorporation.

#### 3.2. Proportional consolidation

The CSSF supervises on the basis of a proportional consolidation in case of a holding between 20% and 50% according to the provisions of Article 51-4(2). The

proportional consolidation can, moreover, be accepted in case of an acquisition of a holding equal to or higher than 50%, but where it is clearly established that the responsibility of the company holding a share of capital is limited to this share of the capital and insofar as the suitability of the other shareholders or members fulfils the CSSF's expectations.

In the case where the consolidating undertaking exerts, in the view of the CSSF, significant influence over the entity to be consolidated without the threshold of 20% being reached, a proportional consolidation is also applicable.

### 3.3. Other methods

In all the cases not covered by the aforementioned provisions, but which are nevertheless included in the scope of the consolidated supervision, the CSSF decides, on a case-by-case basis, which consolidation method is applicable.

## **4. Content of the supervision on a consolidated basis**

Article 51-5 provides that the supervision on a consolidated basis covers at least:

- the supervision of the solvency and of the capital adequacy ratio in relation to market risks;
- the control of large exposures.

Pursuant to Article 51-6, the CSSF also requires that:

- an adequate organisation of the group, in particular at the level of the administration, accounting, internal control as well as the structure of the group in general.

### 4.1. Consolidated supervision of a group controlled by a Luxembourg investment firm

#### 4.1.a. Supervision of the capital adequacy in relation to solvency, foreign-exchange and market risks incurred

Those investment firms falling in the scope of application of Circular CSSF 00/12 defining the capital ratios pursuant to Article 56 of the Law of 5 April 1993 on the financial sector, as amended, and which must therefore comply with the integrated ratio or the simplified ratio provided for by Circular CSSF 00/12 must also comply, at all times, with this ratio on a consolidated basis.

The investment firms concerned are:

- professionals acting for their own account within the meaning of Article 24 C;

- distributors of units/shares in UCIs accepting and making payments within the meaning of Article 24 D;
- underwriters within the meaning of Article 24 E of the Law of 5 April 1993 on the financial sector, as amended.

The practical arrangements for calculating the integrated or simplified ratio on a consolidated basis will be set later in a circular which will deal, in general, with the tables to be filled in by the investment firms subject to Circular CSSF 00/12.

#### 4.1.b. Control of large exposures

Those investment firms falling in the scope of application of Circular CSSF 00/12 must comply, at all times, with the rules relating to large exposure limits as well as with the rules relating to the notification of large exposures also on a consolidated basis.

The practical arrangements for calculating and notifying large exposures on a consolidated basis will be set later in a circular which will deal with the tables to be filled in by the investment firms subject to Circular CSSF 00/12.

It should be noted that the Luxembourg investment firms are, in principle, not authorised to carry out the activity of granting credits. Nevertheless, these undertakings may incur large exposures with respect to their trading book activity.

#### 4.1.c. Internal control procedures for the supervision on a consolidated basis

In the interests of an effective supervision on a consolidated basis, the Luxembourg investment firms must ensure that a sound administrative and accounting organisation and an adequate internal control are in place in their subsidiaries (within the meaning of Article 51-2, 9th indent) in order, in particular, to guarantee the provision and communication of the information useful for this supervision.

The investment firms ensure that the rules set in Circular IML 98/143 are applied by their subsidiaries established in Luxembourg and abroad - without prejudice to the local rules which might exist in this field - insofar as the subsidiaries fall within the scope of application of the consolidated supervision by the CSSF in accordance with this circular.

The parent undertaking may be temporarily unable to fulfil the requirements as described above, for instance immediately following the acquisition of a holding in an existing company. In such case, the CSSF may grant a time-limited exemption.

As regards companies in which a participation between 20% and 50% is held, the Luxembourg undertaking, which is not the parent undertaking, has the responsibility to strive, together with the other shareholders or members concerned, to establish in these companies an internal control system similar to that in place in the Luxembourg undertaking.

In the case where the aforementioned requirements are not fulfilled and the situation is not quickly regularised, the Luxembourg undertaking must envisage to dispose of the holdings in question or at least to reduce them to a level where it will no longer be required to consolidate for supervisory purposes given that the requirements of Article 51-6(1), 3rd indent, of the amended Law of 5 April 1993 cannot be fulfilled. Chapter 5.4.6. of Circular IML 98/143 deals, in particular, with the internal audit tasks to be carried out at the level of subsidiaries and the holdings between 20% and 50%.

#### 4.1.d. Rules on the audits to be carried out by *réviseurs d'entreprises* (statutory auditors)

The external auditor's control of the consolidating undertaking must include the manner in which the consolidating undertaking's management of the group works, as well as the organisation of the subsidiaries and the companies with which there is a link by virtue of a participating holding within the meaning of Article 51-2, 9th indent, of the Law of 5 April 1993 and which are included in the scope of consolidation.

The external audit of investment firms subject to the supervision on a consolidated basis by the CSSF must be carried out according to the generally accepted working standards for the audit of consolidated accounts.

A report is drawn up by the *réviseur* (auditor) following his/her work.

Finally, it should be pointed out that the CSSF recommends mandating a *réviseur d'entreprises* who will take on, in compliance with the relevant professional standards, responsibility for the external audit of the entire group. This recommendation aims to ensure an external audit of equal quality in all the entities of the group and to allow the external auditor in charge of the audit to issue an informed assessment of the group.

#### 4.1.e. Management of all the undertakings falling within the consolidation and the central administrative and accounting organisation

Article 51-6(1), 2nd indent, of the Law of 5 April 1993, as amended by the Law of 29 April 1999, requires that an investment firm, subject to the consolidated supervision of the CSSF, establishes, at its registered office, the management infrastructure and central organisation necessary to assume its function as consolidating undertaking. This provision relates to the management of the group and thereby aims at the centralising functions. It is superimposed, without, however, displacing them, on the legal requirement at the level of the individual investment firm laid down in Article 17(1) of the law on the financial sector and pursuant to which any investment firm authorised in Luxembourg must prove the existence in Luxembourg of its central administration, i.e. the administrative centre and the decision-making centre, as well as similar legal requirements in force in other countries in which the group has establishments.

The notions of management of the group of undertakings falling within the consolidation and central administrative and accounting organisation, introduced by Article 51-6(1), 2nd indent, present similarities with those of the central administration and sound administrative and accounting organisation laid down in Article 17(1) and (2) of the Law of 5 April 1993.

Therefore, a consolidating undertaking, where it is a parent undertaking, cannot simply play a purely administrative role; it must be a decision-making centre. The definition of the business policy of the group as well as the supervision of its application are incumbent upon it which imposes the presence of a proper infrastructure for human resources, information systems, management control as well as internal audit.

Moreover, this function requires the presence, at the registered office of the parent undertaking, for each type of transactions carried out within the group, of an ultimate responsible person having the power to coordinate this type of transactions.

These responsible persons are in charge of proposing, in their respective areas, a common group policy and of ensuring, following the adoption by the competent bodies of the parent undertaking, its application. The implementation at group level of decision-making committees must be envisaged.

Moreover, it is essential that the parent undertaking designates, within its management, a person responsible for the coordination of the information flows with the undertakings in which a participation is held.

The parent undertaking must centralise all information relating to the group and take charge of their transmission to the supervisory authorities. Pursuant to Article 51-6(1), 3rd indent, it must also ensure the reliability of the consolidated statements to be submitted to the CSSF and the adequacy of the reporting system.

In respect of the companies in which a participation between 20% and 50% is held, the consolidating undertaking which is not the parent undertaking, must try together with the other shareholders or members concerned, to include the activity of these companies in the business policy of the group. If it fails to do so, it must envisage to dispose of the holdings or to bring them to a level where it will be no longer required to consolidate them for supervisory purposes.

#### 4.1.f. Prevention of money-laundering activities

Luxembourg standards relating to the fight against money laundering and the prevention of the use of the financial sector for the purposes of money laundering as defined in the Law of 5 April 1993 on the financial sector, as amended (Articles 38 to 41), and specified in Circular IML 94/112 are also applicable within the context of the supervision on a consolidated basis.

In the vein of these texts, all undertakings falling within the consolidated supervision of the CSSF must comply with the Luxembourg rules as regards the prevention of money laundering, without prejudice to the application of specific requirements in their own country of establishment. Indeed, it cannot be accepted that these undertakings are used for money-laundering transactions prohibited in Luxembourg.

Money-laundering rules must be implemented in accordance with point 4.1.c. above. It should be noted that in the same line as provided for in the internal control procedures, the consolidating undertaking must implement Luxembourg standards as regards the prevention of money laundering in the companies concerned.

Its internal audit department must be in charge of verifying within the context of its regular controls that all Luxembourg legal requirements in this regard are complied with.

#### 4.1.g. Acquisition of holdings by subsidiaries

In view of the legal responsibility of consolidated supervision incumbent upon the CSSF and given Articles 18(2) and 51-6(1), 1st indent, of the Law of 5 April 1993 on the financial sector, which require a transparent structure of the groups to enable an unfettered supervision on a consolidated basis, any acquisition of holdings by a subsidiary or a sub-subsidiary of a parent undertaking (within the meaning of Article 51-2, 8th indent, of the law) subject to the consolidated supervision of the CSSF must obtain prior authorisation of the ultimate supervisory authority, i.e. the CSSF. In this respect, reference is made to the provisions of Article 57-1 of the amended Law of 5 April 1993 which are thus applicable, by extension, to these acquisitions of holdings.

#### 4.2. Consolidated supervision of a group controlled by a financial company

It should be borne in mind that the financial company which is a parent undertaking does not necessarily fall within the individual prudential supervision exercised by the CSSF. However, this does not preclude the consolidated group controlled by this financial company from implementing, in general, the same supervisory rules as those mentioned above for the groups having as head a Luxembourg investment firm. The Luxembourg investment firm belonging to the group is, in principle, in charge of compliance with these rules at group level. The CSSF, however, reserves the right to directly address, in the exercise of its consolidated supervision on the group and as far as possible, the financial company which is the parent undertaking. Consequently, the CSSF recommends that such financial companies, which are not subject to its individual supervision, have a sufficient infrastructure enabling them to adequately assume their control function over the group (cf. point 4.2.b. below).

#### 4.2.a. Supervision of capital adequacy in relation to solvency, foreign-exchange and market risks incurred

The rules applicable to the groups controlled by a Luxembourg investment firm, set out in Chapter 4.1.a. are, in general, also applicable to groups having as parent undertaking a financial company.

#### 4.2.b. Control of large exposures

##### Internal control procedures for the supervision on a consolidated basis

The rules referred to in points 4.1.b. and 4.1.c. are also applicable to the groups controlled by a financial company.

It should be specified, as regards the internal control procedures, that where the financial company which heads the group subject to the consolidated supervision of the CSSF is not established in Luxembourg, the investment firm which is a subsidiary governed by Luxembourg law must intervene in order to establish in the companies included in the consolidation an internal control similar to that in place in Luxembourg.

#### 4.2.c. Rules on the audits to be carried out by *réviseurs d'entreprises*

The external audit of the group subject to the supervision on a consolidated basis by the CSSF must be carried out according to generally accepted working standards for the audit of consolidated accounts.

The financial company must produce, for the attention of the CSSF, an audit report issued by its *réviseur d'entreprises*.

The recommendation of the CSSF in respect of the mandate to be conferred to a *réviseur d'entreprises* as mentioned in point 4.1.d. is also applicable to the groups controlled by a financial company.

#### 4.2.d. Management of all the undertakings falling within the consolidation and the central administrative and accounting organisation

A financial company established in Luxembourg which is head of a banking or financial group must prove the existence in Luxembourg of the management of all undertakings falling within the consolidation as well as the central administrative and accounting organisation, so that the economic reality of the activities corresponds to the legal structure of the group. It means, in particular, that the financial company must have enough human and technical resources on site in order to assume its duties as decision-making and control centre of the group. Moreover, it must have, on site in Luxembourg, a general manager informed of the group policy, who has a coordination power on all companies dependent on the group and who acts as contact person of the CSSF.

In the case where the financial company, which is a parent undertaking, is not established in Luxembourg, the central administrative and accounting organisation, as described above (cf. point 4.1.e.) must be put in place in the Luxembourg investment firm belonging to the group. As regards the management of all undertakings falling within the consolidation, the model must be discussed, on a case-by-case basis, with the CSSF based on what is acceptable under the law.

#### 4.2.e. Prevention of money-laundering activities

Reference is made to point 4.1.f. which applies by analogy to the financial company, which is a parent undertaking, as well as to the undertakings included in the consolidated control exercised by the CSSF.

#### 4.2.f. Acquisitions of holdings by subsidiaries

The provisions of point 4.1.g. also extend to the groups controlled by a financial company.

### 4.3. Supervision of a group controlled by a mixed-activity company

Where a Luxembourg investment firm has a mixed-activity company as parent undertaking, this mixed-activity company is required to make available to the CSSF all information including financial information on the group as well as on the individual subsidiary companies, investment firms, financial institutions or ancillary banking services undertakings falling within the consolidated supervision, insofar as the CSSF considers that this data is useful for the exercise of its mission.

Moreover, the CSSF may ask for reports on the specific situation in particular for the financing of other companies of the group which are not included in the scope of consolidation. The CSSF may also require a detailed description on the existing relationships between the financial and non-financial part of the group.

The precise specifications of the information to be provided on a regular basis as well as, where appropriate, the reports to be provided will be discussed on a case-by-case basis.

## **5. Powers of the CSSF over the entities subject to its consolidated supervision**

### 5.1. Right of the CSSF to information

On the basis of Article 51-6(2)(a) and (2)(c), the CSSF is entitled to request entities belonging to a financial group subject to its consolidated supervision for all information it deems necessary for the exercise of this supervision, whether or not these

entities are subject to the prudential supervision of the CSSF on a stand-alone basis or whether or not they are included in the scope of consolidation. In principle, the CSSF receives this information through the parent undertaking of the group.

The CSSF also has a right to information as regards a financial company included in the consolidated supervision even if the financial company is located abroad. The CSSF reserves the right to find an arrangement with the financial company to obtain the required information directly from it. Failing this, the CSSF will address the investment firm authorised in Luxembourg which is part of the group to obtain information.

Pursuant to Article 51-6(4)(a), the institutions are obliged to communicate the required information to the CSSF. If there is a refusal to disclose the requested information, the CSSF may impose the sanctions provided below. The CSSF may, in particular, require a change of structure if there are obstacles to the exchange of information.

As regards all entities falling within the scope of consolidation, but which are not subject to the prudential supervision of the CSSF, the CSSF may request, either directly or indirectly, through the investment firm included in the group, all information useful for the exercise of its mission of supervision on a consolidated basis.

In the cases where the parent undertaking is a mixed-activity company, the latter has an information obligation vis-à-vis the supervisory authorities in order to facilitate the prudential supervision of investment firms which are subsidiaries, whereas in the case of a parent undertaking which is a financial company, the latter is subject to the consolidated supervision on the basis of the financial situation of the entire group. As regards the groups dominated by a mixed-activity company, the CSSF will simply request information relating to the financial part of the group. The structure of the group must thus enable to clearly separate the financial part from the rest of the group. If not, a group's restructuring may be necessary.

Moreover, the CSSF is entitled to carry out on-site inspections or to have the accuracy and completeness of the information received checked by an external auditor appointed for this purpose. These powers also exist as regards a mixed-activity company and all subsidiaries of the latter.

Within the context of the collaboration between the supervisory authorities and for the purpose of facilitating the supervision of international groups, the CSSF reserves the right to request, within the context of its competences, information on an investment firm, a credit institution, a financial company, a financial institution, an ancillary banking services undertaking, a mixed-activity company or their subsidiaries, if it receives such information request from the competent authorities of another Member State. Companies established in Luxembourg and dependent on a group whose consolidated supervision is exercised by a foreign supervisory authority may also be

required to provide information directly to this authority, insofar as this information is expected to facilitate the supervision of the group on a consolidated basis.

## 5.2. Sanctions

### 5.2.a. Case of a parent undertaking supervised by the CSSF

In case of a refusal by an undertaking subject to the prudential supervision of the CSSF on a stand-alone basis to disclose the requested information, the CSSF may apply towards this undertaking the sanctions provided for by the Law of 5 April 1993 on the financial sector, as amended, within the context of the non-consolidated prudential supervision; these sanctions range from the injunction and suspension to the issue of administrative fines (Articles 59 and 63 of the aforementioned law).

Moreover, in order to guarantee a transparent structure of the banking or financial groups as well as an adequate consolidated supervision without obstacles, as provided for by Article 51-6(1), first indent, the CSSF has the legal power to refuse certain group structures deemed inappropriate. Indeed, given that any qualifying holding must receive prior authorisation by the CSSF provided for in Article 57(1) of the Law of 5 April 1993 on the financial sector, as amended, the CSSF may reject an acquisition of a holding or withdraw its authorisation, respectively, if it considers that the legal conditions in this respect are not/no longer fulfilled. This option enables it thus to ensure that the structure of a group remains transparent.

### 5.2.b. Case of a parent undertaking not supervised by the CSSF

In the case where an undertaking, which is not subject, on a stand-alone basis, to the prudential supervision of the CSSF and which is the parent undertaking of at least one Luxembourg investment firm, does not provide the CSSF with the requested information, the latter may, in accordance with Article 51-6(5) of the amended Law of 5 April 1993 issue injunctions and administrative fines against the entity in question.

If the injunction is not acted upon within the period set, the CSSF may draw the conclusion that the suitability of the shareholder of the group to which the investment firm belongs does no longer guarantee a sound and prudent management of the investment firm and does no longer fulfil the authorisation conditions provided for in Article 18(1) of the Law of 5 April 1993 on the financial sector.

Moreover, in order to guarantee an adequate consolidated supervision and a transparent structure of the banking and financial groups, the CSSF may acknowledge that Article 18(2) of the Law 5 April 1993 is not complied with by the investment firm governed by Luxembourg law as it belongs to a non-transparent group or because its parent undertaking objects to an adequate supervision on a consolidated basis.

## **B) CASE OF GROUPS WHICH INCLUDE INVESTMENT FIRMS AS WELL AS ONE OR SEVERAL CREDIT INSTITUTIONS**

### **1. Foreign credit institutions:**

#### **Scope of application and content of the supervision on a consolidated basis**

##### **1.a) Consolidating investment firm:**

Investment firms governed by Luxembourg law which have one or several foreign credit institutions as subsidiaries or which hold a participation in one or several foreign credit institutions are subject to supervision on a consolidated basis by the CSSF.

The investment firms authorised in Luxembourg cannot benefit from an exemption from the consolidated supervision to be exercised by the CSSF by the mere fact that they are themselves subsidiaries of an investment firm or credit institution supervised by a supervisory authority of another EC Member State.

The supervision on a consolidated or, where appropriate, on a sub-consolidated basis is carried out by the CSSF to the same extent and in accordance with the methods as defined in Chapter A of this circular.

As regards the content of its supervision on a consolidated basis, the CSSF carries out, however, a lighter supervision than the one set out in point 4 of Chapter A of this circular, if the supervision on a consolidated basis is carried out by the CSSF alongside the one carried out by the foreign authority competent to carry out a supervision on a consolidated basis of the foreign credit institution belonging to the group. Thus, the consolidated supervision by the CSSF is limited to the sole supervision of solvency, capital adequacy in relation to market risks and large exposures.

The supervision on a consolidated or, where appropriate, sub-consolidated basis carried out by the CSSF does not affect the supervision on a non-consolidated basis.

However, the CSSF may choose, on a sub-consolidated or individual basis, not to apply the rules referred to in the preceding sub-paragraph in the two cases laid down in Article 51-5(3)(a) and (b).

##### **1.b) Consolidating financial company**

In respect of any investment firm governed by Luxembourg law whose parent undertaking is a financial company located in Luxembourg or in the Community which has a foreign credit institution as subsidiary or which holds a participation in a foreign credit institution, the CSSF carries out a prudential supervision based on the consolidated

financial situation of the financial company, to the extent and in accordance with the methods as defined in Chapter A of this circular.

Here again, the supervision on a consolidated basis carried out by the CSSF is lighter if it is combined with the one carried out due to the presence of one or several credit institutions in the group. In such a case, the supervision on a consolidated basis carried out by the CSSF only covers solvency, capital adequacy in relation to market risks and supervision of large exposures. It does not affect the supervision on a non-consolidated basis.

## **2. Credit institutions governed by Luxembourg law:**

### **Scope of application and content of the supervision on a consolidated basis**

Investment firms governed by Luxembourg law which have one or several Luxembourg credit institutions as subsidiaries or which hold a participation in a Luxembourg credit institution are subject to supervision on a consolidated basis by the CSSF.

The investment firms authorised in Luxembourg cannot benefit from an exemption from the consolidated supervision to be exercised by the CSSF by the mere fact that they are themselves subsidiaries of an investment firm or credit institution supervised by a supervisory authority of another EC Member State.

The supervision on a consolidated or, where appropriate, on a sub-consolidated basis is carried out by the CSSF to the same extent and according to the same methods as defined in Chapter III of the amended Law of 5 April 1993 and specified in Circular IML 95/125.

In respect of any investment firm governed by Luxembourg law whose parent undertaking is a financial company which has a Luxembourg credit institution as subsidiary or which holds a participation in a Luxembourg credit institution, the CSSF carries out a prudential supervision based on the consolidated financial situation of the financial company, to the extent and in accordance with the methods as defined in Chapter III of the amended Law of 5 April 1993, specified in the framework of Circular 95/125, as regards the supervision on a consolidated basis to be carried out due to the presence of a bank in the group.

## **III. PRACTICAL REQUIREMENTS**

### **List of companies included in the scope of the supervision on a consolidated basis**

All investment firms are required to provide the CSSF, at the latest on 28 February 2001, with a list established as at 31 December 2000 of the companies in which they hold a participation as well as of other companies referred to in point II.2.1.c., 2nd subparagraph, in order to enable the CSSF to determine the scope of the consolidated supervision. This list will include for each relevant company:

- the exact name and address of the company;
- the amount and percentage of the holding as well as any other information as regards the supervision exercised on the company (effective influence, possible agreements with other members, etc);
- the balance sheet total of the company (if Article 51-3(4), 2nd indent, is invoked);
- a precise indication of the activities of the company;
- the method of to be consolidation applied (full consolidation, proportional consolidation, other method, exclusion from the scope of application of the consolidation) and its justification on the basis of the legal provisions.

The investment firms inform the CSSF of any change to the data included in the aforementioned list. The same information is also to be communicated to the CSSF prior to any new acquisition of a holding.

The other practical requirements relating to the consolidated supervision carried out by the CSSF will be set later.

Yours faithfully,

COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER

Charles KIEFFER  
Director

Arthur PHILIPPE  
Director

Jean-Nicolas SCHAUS  
Director General

## **ANNEXE: DEFINITIONS**

**Financial company:** a financial institution the subsidiary undertakings of which are either exclusively or mainly investment firms or financial institutions, one of these subsidiaries at least being an investment firm;

**Mixed-activity company:** a parent undertaking other than a financial company or an investment firm which, among its subsidiaries, has at least one investment firm;

**Ancillary banking services undertaking:** an undertaking the principal activity of which consists in owning or managing property, managing IT services, or any other similar activity which is ancillary to the principal activity of one or more credit institutions;

**Parent undertaking:** an undertaking which:

- has the majority of the voting rights of shareholders or members of an undertaking; or
- is entitled to appoint or dismiss the majority of the members of an undertaking's administrative, management or supervisory body and is, at the same time, a shareholder or member in that undertaking; or
- is a shareholder or member in an undertaking and, by virtue of an agreement entered into with other shareholders or members in that undertaking, has sole control of the majority of its shareholders' or members' voting rights; as well as any undertaking that actually exercises, in the view of the CSSF, a dominant influence on another undertaking;

**Credit institution:** all undertakings included in the list published in the Official Journal of the European Communities in accordance with Article 3(7) of Directive 77/780/EEC;

- all private or public undertakings which are not established in the EC, which have the status of bank or credit institution and which are included in their respective countries in the official table of banks or credit institutions, if such a table exists;
- the other institutions whose business is to receive deposits or other repayable funds from the public and to grant credits for their own account;

**Financial institution:** an undertaking other than a credit institution or an investment firm, the principal activity of which is to acquire holdings or to carry on one or more of the activities referred to in points 2 to 12 of the list included as Annexe I to the Law of 5 April 1993 on the financial sector, as amended;

**Subsidiary:** an undertaking in respect of which a parent undertaking

- has the majority of the voting rights of the shareholders or members; or
- is entitled to appoint or dismiss the majority of the members of an undertaking's administrative, management or supervisory body and is, at the same time, a shareholder or member; or
- is a shareholder or member and, by virtue of an agreement entered into with other shareholders or members, has sole control of the majority of its shareholders' or members' voting rights;

as well as any undertaking on which a parent undertaking actually exercises, in the view of the CSSF, a dominant influence;

any subsidiary undertaking of a subsidiary undertaking is also considered as subsidiary of the undertaking that heads these undertakings;

**Dominant influence:** situation where the dominant company has means which enable it to submit the dominated undertaking to its will and to impose its will; in principle, this domination is exercised by means of a contract (for instance "Beherrschungsvertrag") or by virtue of a clause in the articles of incorporation;

**Holding:** the direct or indirect holding in 20% or more of an undertaking's voting rights or capital.