Commission de Surveillance du Secteur Financier

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

Luxembourg, 10 December 2015

To all credit institutions, investment firms, asset management companies and alternative investment fund managers

CIRCULAR CSSF 15/629, as amended by Circular CSSF 16/641

Re: **Supplementary supervision to be applied to financial conglomerates and definition of structure coefficients to be observed by the regulated entities belonging to these financial conglomerates pursuant to Article 56 of the law of 5 April 1993 on the financial sector, as amended**

Ladies and Gentlemen,

The law of 23 July 2015 transposing CRD IV[1] (hereinafter the "**Law**") also completed the transposition of Directive 2011/89/EU of the European Parliament and of the Council of 16 November 2011 amending Directives 98/78/EC, 2002/87/EC, 2006/48/EC and 2009/138/EC as regards the supplementary supervision of financial entities in a financial conglomerate (hereinafter "**Directive 2011/89/EU**").

The Law transposed the provisions of Article 2 of Directive 2011/89/EU which amends the provisions of Directive 2002/87/EC (hereinafter the "**Financial Conglomerates Directive**")[2] relating to supplementary supervision of financial conglomerates, with a

[1] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC ("**CRD IV**"). For details regarding the transposition of CRD IV by the law of 23 July 2015, please refer to Circular CSSF 15/620.

[2] Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (FICOD).

view to remedying unintended consequences and technical omissions in the sectoral directives on credit institutions, investment firms and insurance undertakings and ensuring that the Financial Conglomerates Directive's objectives are indeed achieved.

Therefore, the Law made a certain number of changes to Chapter 3bis of the law of 5 April 1993 on the financial sector (hereinafter "**LFS**"), whose provisions were derived from the law of 5 November 2006 on the supervision of financial conglomerates and which transposed the Financial Conglomerates Directive. Moreover, this law had been supplemented by Circular CSSF 06/268 of 29 November 2006 relating to the supplementary supervision of financial conglomerates and definition of structure coefficients to be observed by these financial conglomerates in accordance with article 56 of the LFS ("**Circular CSSF 06/268**").

The purpose of this circular is to repeal Circular CSSF 06/268 which became partly obsolete following the adoption of the Law and to transpose the amendments introduced by Article 2(24) of Directive 2011/89/EU to Annex I of the Financial Conglomerates Directive with respect to the capital adequacy for regulated entities belonging to a financial conglomerate. More specifically, Annex I amends the technical methods for calculating the supplementary capital adequacy requirements for these regulated entities where a competent authority exercises the role of coordinator.

The purpose of this circular is not to repeat the amended content of Circular CSSF 06/268 whose aim was to explain the provisions of the law of 5 November 2006, but simply to restate the main principles of supplementary supervision of financial conglomerates. For further information, please refer to Articles 51-9 to 51-26 of the LFS.

1. Reminder on the supplementary supervisory framework

The concept of financial conglomerate is defined in detail in Article 51-9(5) and in Article 51-10 of LFS. In any case, in order to qualify as a "financial conglomerate" a group or a subgroup must include at the same time and at least one significant regulated entity within the banking or investment firms sector and one significant entity within the insurance sector. A "regulated entity" means, in accordance with Article 51-9(7) of the LFS, a credit institution, an insurance undertaking, a reinsurance undertaking, an investment firm, an asset management company or an alternative investment fund manager (as defined in Article 51-9 of the LFS).

With regard to Luxembourg credit institutions or investment firms belonging to a financial conglomerate for which its exercises the role of coordinator in accordance with Article 51-17, the CSSF exercises a supplementary supervision of the financial conglomerate in accordance with Articles 51-13 to 51-24 of the LFS. In this respect, all the financial sector entities belonging to the financial conglomerate, whether regulated or not, established in a Member State or in a third country, are part of the scope of supplementary supervision exercised by the CSSF.

The supplementary supervision exercised by the CSSF covers:

- the financial position of the financial conglomerate in general and capital adequacy in particular (Article 51-13 of the LFS);
- risk concentration (Article 51-14 of the LFS);
- intra-group transactions (Article 51-15 of the LFS);
- internal control mechanisms and risk management processes (article 51-16 of the LFS); and
- the management body where a mixed financial holding company heads the financial conglomerate (Article 51-20 of the LFS).

Luxembourg credit institutions and investment firms belonging to a financial conglomerate for which a competent authority other than the CSSF (which may be the Commissariat aux Assurances or a competent authority of another Member State) exercises the role of coordinator, are also subject to a supplementary supervision, within the scope and according to the arrangements laid down in Articles 51-13 to 51-24 of the LFS.

The rules relating to the supplementary supervision, as laid down in the LFS, are without prejudice to the sectoral rules applicable to the regulated entities belonging to a financial conglomerate. Furthermore, the supplementary supervision exercised by the CSSF affects neither the supervision on a consolidated basis, nor the supervision on an individual basis.

2. Supplementary supervision of capital adequacy

Pursuant to Article 51-13 of the LFS, credit institutions and investment firms in a financial conglomerate, for which the CSSF exercises the role of coordinator, shall ensure that own funds that are always at least equal to the capital adequacy requirements are available at the level of the financial conglomerate.

In accordance with that article, the CSSF, in its capacity as coordinator responsible for the supplementary supervision of a financial conglomerate, prescribes that one of the following three methods for the calculation of capital adequacy be applied by the financial conglomerate. Before deciding on a calculation method for capital adequacy, the CSSF consults with other relevant competent authorities and the financial conglomerate itself.

Following this consultation, the CSSF determines, for each financial conglomerate, the information (own funds, global solvency requirements for each sector, etc.) to notify in this context, as well as the notification procedures and the periodicity, which shall be at least annual.

a. Technical method for calculating supplementary requirements

One of the following three methods may be used to calculate the supplementary capital adequacy requirements.

1. Accounting consolidation method

The calculation of the supplementary capital adequacy requirements of the regulated entities in a financial conglomerate shall be carried out on the basis of the consolidated accounts.

The supplementary capital adequacy requirements shall be calculated as the difference between:

(i) the own funds of the financial conglomerate calculated on the basis of the consolidated position of the group; the elements eligible are those that qualify in accordance with the relevant sectoral rules;
and
(ii) the sum of the solvency requirements for each different financial sector represented in the group; the solvency requirements for each different financial sector are calculated in accordance with the corresponding sectoral rules.

A notional solvency requirement shall be calculated for non-regulated financial sector entities which are not included in the aforementioned sectoral solvency requirement calculations.

"When applying this method, the supplementary capital adequacy requirements of a financial conglomerate, the own funds and solvency requirements of the group's entities shall be calculated by applying the corresponding sectoral rules relating to the form and extent of the consolidation, as laid down, in particular, in Article 18 of Regulation (EU) No 575/2013[3] [4] and in Article 221 of Directive 2009/138/EC[5]."[6] The difference shall not be negative.

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[3] Article 18 of Regulation (EU) No 575/2013 restates the provisions of Articles 133 and 134 of the repealed Directive 2006/48/EC.
[4] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.
[5] Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).
[6] Circular CSSF 16/641.

2. Aggregation and deduction method

The calculation of the supplementary capital adequacy requirements of the regulated entities in a financial conglomerate shall be carried out on the basis of the accounts of each of the entities in the group.

The supplementary capital adequacy requirements shall be calculated as the difference between:

> (i) the sum of the own funds of each regulated and non-regulated financial sector entity in the financial conglomerate; the elements eligible are those which qualify in accordance with the relevant sectoral rules;
> and
> (ii) the sum of
>
> - the solvency requirements for each regulated and non-regulated financial sector entity in the group; the solvency requirements shall be calculated in accordance with the relevant sectoral rules, and
> - the book value of the participations in other entities of the group.

A notional solvency requirement shall be calculated for non-regulated financial sector entities which are not included in the aforementioned sectoral solvency requirement calculations.

When applying this method, the calculation (for own funds and solvency requirements) shall take account of the proportion held, directly or indirectly, by the parent undertaking or undertaking which holds a participation in another entity of the group.

The difference shall not be negative.

3. Combination method

The CSSF may allow a combination of methods 1 and 2 above.

b. <u>Technical principles for calculating supplementary requirements</u>

The calculation of the supplementary capital adequacy requirements of the regulated entities in a financial conglomerate shall be carried out according to the following technical principles.

i. <u>Extent and form of the supplementary capital adequacy requirements calculation</u>

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 CSSF, acting as 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 CSSF may give permission for the solvency deficit of the subsidiary undertaking to be taken into account on a proportional basis.

Where there are no capital ties between entities in a financial conglomerate, the CSSF, acting as coordinator, after consultation with the other relevant competent authorities, shall determine which proportional share will have to be taken into account, bearing in mind the liability to which the existing relationship gives rise.

ii. Other technical principles

Regardless of the method used for the calculation of the supplementary capital adequacy requirements of regulated entities in a financial conglomerate as laid down in Section 2(a) above, the CSSF, acting as coordinator, and, where necessary, together with the other relevant competent authorities concerned, shall ensure that the following principles apply:

(i) the multiple use of elements eligible for the calculation of own funds at the financial conglomerate level ("multiple gearing") as well as any inappropriate intra-group creation of own funds must be eliminated; in order to ensure the elimination of multiple gearing and the intra-group creation of own funds, the CSSF shall apply by analogy the relevant principles laid down in the relevant sectoral rules;

(ii) solvency requirements for each different financial sector represented in a financial conglomerate shall be covered by own funds elements in accordance with the corresponding sectoral rules. When there is a deficit of own funds at the financial conglomerate level, only own funds elements which are eligible according to each of the sectoral rules ("cross-sector capital") shall qualify for verification of compliance with the additional solvency requirements.

Where sectoral rules provide for limits on the eligibility of certain own funds instruments, which would qualify as cross-sector capital, these limits would apply *mutatis mutandis* when calculating own funds at the financial conglomerate level.

When calculating own funds at the financial conglomerate level, the CSSF 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.

Where, in the case of a non-regulated financial sector entity, a notional solvency requirement is calculated in accordance with Section 2(a) above, 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.

3. Entry into force

This circular repeals and replaces Circular CSSF 06/268 and enters into force immediately.

Yours faithfully,

COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER

Claude SIMON Director	Andrée BILLON Director	Simone DELCOURT Director	Jean GUILL Director General