COMMISSION de SURVEILLANCE du SECTEUR FINANCIER

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

Luxembourg, 29 November 2006

To all credit institutions and investment firms

CIRCULAR CSSF 06/268

relating to the supplementary supervision of financial conglomerates and defining structure coefficients to be observed by these financial conglomerates in accordance with article 56 of the law of 5 April 1993 on the financial sector as amended

Ladies and Gentlemen,

The law of 5 November 2006 relating to the supervision of financial conglomerates introduces a supplementary supervision on financial conglomerates into Luxembourg law. A financial conglomerate is a group including at least one important regulated entity within the banking or investment services sector and one important entity within the insurance sector.

The law requires the CSSF to perform a supplementary supervision of the financial conglomerates for which it exercises the role of coordinator of the supervision (i.e. the authority responsible for the coordination and supplementary supervision at the level of the financial conglomerate). The law also provides that the CSSF may be requested to cooperate, in its role as competent authority (when in charge of the supervision of one or more credit institutions or investment firms in a financial conglomerate) or as relevant competent authority (when responsible for the sectoral group-wide supervision of the regulated entities in a financial conglomerate) with the coordinator of the supervision of a financial conglomerate, which could be the "Commissariat aux Assurances" or any competent authority of another EU or EEA Member State.

The supplementary supervision exercised by the CSSF on financial conglomerates does not affect the sectoral prudential supervision, both on the individual and

consolidated level, by the relevant competent authorities. In particular, the legal provisions as well as the circulars 96/125 and 00/22 relating to the supervision of credit institutions and investment firms on a consolidated basis by the CSSF remain valid.

The circular's annexe details the aim and the approach of the new law, the scope of the supplementary supervision, the identification of financial conglomerates and the practical consequences of the new law.

Furthermore, in accordance with articles 51-13 (capital adequacy), 51-14 (risk concentration) and 51-15 (intra-group transactions) of the law of 5 April 1993 on the financial sector as amended, the CSSF, in its capacity as coordinator, shall determine, under article 56 of this law, the calculation and notification procedures regarding own funds, risk concentration and intra-group transactions that financial conglomerates must follow. This circular's annexe provides further clarifications on this subject.

The practical consequences of this law for Luxembourg credit institutions and investment firms are however limited as things stand at present. Indeed, the CSSF has not identified any financial conglomerate for which it should exercise the role of coordinator of this supplementary supervision at this stage. Furthermore, for credit institutions and investment firms in a financial conglomerate for which the "Commissariat aux Assurances" or any competent authority in another Member State is in charge of coordinating the supplementary supervision, the practical impact of this law is, in principle, limited to the cooperation between the CSSF and such authorities. However, this cooperation should, in principle, essentially be based on information obtained under the individual or consolidated supervision of these institutions. Should the CSSF, in the context of this cooperation, require information which is not directly available through the reporting in force, it will contact the concerned credit institutions and investment firms.

Yours faithfully,

COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER

Simone DELCOURT	Arthur PHILIPPE	Jean-Nicolas SCHAUS
Director	Director	Director General

Annexe

Annexe to circular CSSF 06/268

INTRODUCTION

The law of 5 November 2006 relating to the supervision of financial conglomerates (hereinafter referred to as "new law") transposes 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 into Luxembourg law.

The circular details the aim and the approach of the new law, the scope of the supplementary supervision, the identification of the financial conglomerates, the practical consequences of the new law and the supplementary supervision procedures.

In accordance with articles 51-13 (capital adequacy), 51-14 (risk concentration) and 51-15 (intra-group transactions) of the law of 5 April 1993 on the financial sector as amended, the CSSF shall, in its role as coordinator, determine, on the basis of article 56 of this law, the calculation and notification procedures regarding own funds, risk concentration and intra-group transactions that financial conglomerates should respect. This circular provides details on this subject and, as regards capital adequacy more specifically, implements Annexe I of Directive 2002/87/EC into Luxembourg law.

I. AIM AND APPROACH OF THE NEW LAW.

1. The concept of financial conglomerate is defined in detail in article 51-9(5) and in article 51-10 of the law of 5 April 1993 on the financial sector as amended. In any case, in order to be qualified as a "financial conglomerate" a group should mandatorily include at the same time and at least one important regulated entity within the banking or investment firms sector and one important entity within the insurance sector.

2. While the prudential supervision so far exercised by the CSSF was limited to the banking and/or investment firms sector, the supplementary supervision is, under these new legal provisions, extended to the insurance sector as well. The new law aims at taking into account the emergence in recent years of groups operating both in the banking and investment services sector and in the insurance sector, by introducing a cross-sectoral prudential supervision. This supplementary supervision shall however not affect, in any way, the sectoral prudential supervision, both on the individual and consolidated level, by the competent authorities on their respective sectors. In particular, the legal provisions as well as the circulars 96/125 and 00/22 relating to the supervision of credit institutions and investment firms exercised on a consolidated basis by the CSSF remain valid.

3. Supplementary supervision at the level of the financial conglomerate covers the following aspects:

- capital adequacy;
- risk concentration;
- intra-group transactions;
- internal control and risk management;
- management.

4. The new law introduces the role of "coordinator". The "coordinator" is the competent authority responsible for the coordination and supplementary supervision at the level of the financial conglomerate. The coordinator is appointed as defined in article 51-17 of the law of 5 April 1993 on the financial sector as amended. In order to ensure proper supplementary supervision of a financial conglomerate, a single coordinator is appointed for each financial conglomerate.

5. The new law requires close consultation and cooperation between the supervisory authorities in charge of regulated entities in a financial conglomerate. To that effect, it introduces the concept of "relevant competent authority" (cf. article 51-9 of the law of 5 April 1993 on the financial sector as amended). Relevant competent authorities shall mean the coordinator, any competent authority responsible for the consolidated sectoral supervision of regulated entities in a financial conglomerate and, in certain cases, other authorities concerned, where relevant in the opinion of the coordinator and the competent authorities responsible for the consolidated sectoral supervision.

II. SCOPE.

6. Supplementary supervision as defined in the new law is only exercised on those financial conglomerates for which the CSSF has been appointed coordinator in accordance with article 51-17 of the law of 5 April 1993 on the financial sector as amended. Generally, the CSSF exercises this role where a credit institution or investment firm authorised under the law of 5 April 1993 on the financial sector as amended is at the head of a financial conglomerate or where a financial conglomerate is headed by a mixed financial holding company which is the parent undertaking of a credit institution or an investment firm authorised under the law of 5 April 1993 on the financial sector as amended.

7. The CSSF could be coordinator in other cases, as further defined in article 51-17(4) to (7) of the law of 5 April 1993 on the financial sector as amended.

8. Any subgroup defined as financial conglomerate is considered a financial conglomerate. This implies that supplementary supervision is also applicable to these subgroups even if they are included in a larger group subject to supplementary supervision, unless the CSSF exercises the exemptions referred to in article 51-12(2) of the law of 5 April 1993 on the financial sector as amended.

9. The new law also applies to financial conglomerates whose parent undertaking has its head office outside the EU or the EEA and which are not subject to supplementary supervision equivalent to the one described under the law of 5 April 1993 on the financial sector as amended. The CSSF will then determine the applicable supplementary supervision on a case-by-case basis.

10. The scope of the supplementary supervision by the CSSF on a financial conglomerate is extended to all entities, regulated or not, of the banking, insurance and investment firms sectors.

III. IDENTIFICATION OF FINANCIAL CONGLOMERATES.

11. Pursuant to article 51-11 of the law of 5 April 1993 on the financial sector as amended, the CSSF is required to identify any group included in the scope of the new law. The thresholds for identifying a financial conglomerate are laid down in article 51-10 of the law of 5 April 1993 on the financial sector as amended. A group will be defined as a financial conglomerate if at least 40% of its activity (measured in terms of balance sheet total) is in the financial sector and at least 10% (in terms of balance sheet total and capital requirement) or EUR 6 billion (in terms of balance sheet total) of its financial activity are in each of the insurance sector and the combined banking/investment sector.

12. The Commission shall inform, where applicable, credit institutions and investment firms which have been identified as head of a financial conglomerate of the adopted supplementary supervision procedures.

IV. PRACTICAL CONSEQUENCES OF THIS LAW FOR CREDIT INSTITUTIONS AND INVESTMENT FIRMS.

13. A distinction should be made between credit institutions and investment firms included in a financial conglomerate for which the CSSF exercises the role of coordinator and those for which the CSSF does not exercise the role of coordinator due to the fact that the coordination of supplementary supervision shall be the responsibility of either the "Commissariat aux Assurances" or of a competent authority of another EU or EEA Member State.

IV. 1. Credit institutions or investment firms in a financial conglomerate for which the CSSF exercises the role of coordinator.

14. Where the CSSF is appointed as coordinator of the supplementary supervision of a financial conglomerate, the supervision will follow the procedure as set out in Part V. below.

IV. 2. Credit institution or investment firm in a financial conglomerate for which the CSSF does not exercise the role of coordinator.

15. The CSSF does not exercise the role of coordinator when this role is exercised by the "Commissariat aux Assurances" or by a competent authority of a different Member State. The main consequence of the new law on credit institutions and investment firms in a financial conglomerate concerns the cooperation between the CSSF, as competent authority or relevant competent authority, and the coordinator, or other competent authorities or relevant competent authorities respectively. The impact of supplementary supervision for these entities remains limited, in principle, considering that the cooperation of the CSSF with other authorities should be based essentially on information received in the context of individual or consolidated supervision of concerned institutions. The information is detailed in article 51-19(1) and (2) of the law of 5 April 1993 on the financial sector as amended.
Should the CSSF, in the context of this cooperation, require information which is not directly available through the reporting in force, it will contact the concerned credit institutions and investment firms.

V. PROCEDURE FOR THE SUPPLEMENTARY SUPERVISION OF A CONGLOMERATE FOR WHICH THE CSSF EXERCISES THE ROLE OF COORDINATOR.

16. Where the CSSF exercises the role of coordinator of the supplementary supervision of a financial conglomerate, the supervision will cover in particular the following points:

- capital adequacy;
- risk concentration;
- intra-group transactions;
- internal control mechanisms and risk management processes;
- management (where a mixed financial holding company is at the head of the financial conglomerate).

17. Capital adequacy

Pursuant to article 51-13 of the law of 5 April 1993 on the financial sector as amended, credit institutions and investment firms in a financial conglomerate, for which the CSSF exercises the role of coordinator, shall ensure that own funds available at the level of the financial conglomerate are always at least equal to the capital adequacy requirements.

In accordance with this article, the CSSF, in its capacity as coordinator responsible for the supplementary supervision of a financial conglomerate, requires one of the following four methods to be applied for the calculation of capital adequacy 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 periodicity which shall be at least annual.

The four methods indicated below 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.

The difference shall not be negative.

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 (concerning own funds and solvency requirements) shall take account of the proportional share held by the parent undertaking or undertaking which holds a participation in another entity of the group. "Proportional share" means the proportion of the subscribed capital which is held, directly or indirectly, by that undertaking.

The difference shall not be negative.

3. Requirement 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 own funds of the parent undertaking or the entity at the head of the financial conglomerate; the elements eligible are those which qualify in accordance with the relevant sectoral rules;

and

(ii) the sum of

- the solvency requirement of the parent undertaking or the head referred to in (i), and

- the higher of the book value of the former's participation in other entities in the group and these entities' solvency requirements; the solvency requirements of the latter shall be taken into account for their proportional share. "Proportional share" means the proportion of the subscribed capital which is held, directly or indirectly, by the parent undertaking or undertaking which holds a participation in another entity 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 valuing the elements eligible for the calculation of the supplementary capital adequacy requirements, participations may be valued by the equity method.

The difference shall not be negative.

4. Combination of methods 1, 2 and 3

The CSSF may allow a combination of two or all three methods.

Examples of the different capital adequacy calculation methods are available in the document "Capital adequacy principles paper" issued by the Joint Forum (cf. http://www.bis.org/publ/joint02.pdf#page=15).

<u>Common principles of the supplementary capital adequacy requirements calculation methods:</u>

- The solvency requirements to be taken into account for credit institutions are set out in circular CSSF 2000/10[1] defining capital ratios pursuant to article 56 of the law of 5 April 1993 on the financial sector as amended.

  The solvency requirements to be taken into account for investment firms are set out in circular CSSF 2000/12[2] defining capital ratios pursuant to article 56 of the law of 5 April 1993 on the financial sector as amended.

  The solvency requirements to be taken into account for the entities in the insurance sector are defined in Directive 98/78/EC.

  For asset management companies, solvency requirement means the capital requirement set out in article 5a(1)(a) of Directive 85/611/EEC.

- The total amount of the solvency deficit in a regulated entity, respectively the notional deficit in own funds in the case of non-regulated entities, shall be taken into account.

  Where the responsibility of the parent undertaking is proportionally limited to the share of capital owned, the CSSF may give permission that only the part of the deficit relating to the proportion held in the concerned entity is taken into account.

[1] The reference shall be subject to review.
[2] The reference shall be subject to review.

Where there are no capital ties between entities in a financial conglomerate, the Commission, 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.

- Regardless of the method used, double or 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. To this effect, the relevant principles laid down in the sectoral rules shall apply by analogy.

- 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 compliance with the additional solvency requirements.

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

  When considering own funds elements at the level of the financial conglomerate, the CSSF shall also take into account any limits as regards availability and transferability of the own funds across the different legal entities in the group, given the objectives of the capital adequacy rules.

- The notional solvency requirement for a non-regulated financial sector entity is the requirement which such entity should satisfy in accordance with the sectoral rules which would apply if this undertaking were a regulated undertaking of the concerned 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.

18. Risk concentration

Pursuant to article 51-14 of the law of 5 April 1993 on the financial sector as amended, credit institutions and investment firms in a financial conglomerate, for which the CSSF exercises the role of coordinator, report on a regular basis and at least annually any significant risk concentration at the level of the financial conglomerate to the CSSF.

The CSSF shall define for each financial conglomerate, after consultation with the other competent authorities and the financial conglomerate, and taking into account the specific group and risk management structure of the financial conglomerate, the risk

categories to report, the notification thresholds and procedures, including periodicity, of significant risk concentration.

19. Intra-group transactions

Pursuant to article 51-15 of the law of 5 April 1993 on the financial sector as amended, credit institutions and investment firms in a financial conglomerate, for which the CSSF exercises the role of coordinator, report on a regular basis and at least annually any significant intra-group transaction at the level of the financial conglomerate.

The CSSF shall define for each financial conglomerate, after consultation with the other competent authorities and the financial conglomerate, and taking into account the specific group and risk management structure of the financial conglomerate, the risk categories to report, the notification thresholds and procedures, including periodicity, of significant intra-group transactions.

20. Internal control mechanisms and risk management processes

The CSSF shall in particular monitor the proper implementation, at the level of the financial conglomerate, of the provisions laid down in article 51-16 of the law of 5 April 1993 on the financial sector as amended.

21. Management body of a mixed financial holding company at the head of a financial conglomerate

Pursuant to article 51-20 of the law of 5 April 1993 on the financial sector as amended, persons who effectively direct the business of a mixed financial holding company shall be of sufficiently good repute and have sufficient experience to perform those duties. To this effect, a request with supporting documents (curriculum vitae, extract from the criminal record and a sworn statement) shall be provided to the CSSF for the approval of the mixed financial holding company's directors.

VI. ENTRY INTO FORCE OF THE CIRCULAR.

This circular comes into force with immediate effect.