

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

Luxembourg, 30 January 1996

Circular IML 96/125

To all credit institutions

Re: Supervision of credit institutions on a consolidated basis
by the Institut Monétaire Luxembourgeois

Ladies and Gentlemen,

The law of 3 May 1994 published in Mémorial A No 39 of 24 May 1994 transposes into Luxembourg law Council Directive 92/30/EEC of 6 April 1992 on the supervision of credit institutions on a consolidated basis. It amends the law of 5 April 1993 on the financial sector by replacing Chapter 3 (Articles 48 to 51) of Part III by Articles 48 to 51-1 (new). In what follows, reference is made to the articles of the law of 5 April 1993 as amended by the law of 3 May 1994.

The purpose of this circular is to specify, for the credit institutions falling within its scope of application, the practical implications of the new rules for the supervision on a consolidated basis. It is not aimed at branches of credit institutions or credit institutions which do not hold or do not intend to hold direct or indirect holdings in other credit institutions or other financial institutions or credit institutions which do not belong to groups dominated by a financial company or a mixed-activity company.

This circular repeals and replaces Circular IML 86/35.

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I. PURPOSE AND APPROACH OF THE NEW LAW

The prudential supervision of the credit institutions on a consolidated basis has already been established by Council Directive 83/350/EEC transposed into Luxembourg law by the law of 28 January 1986. The new regulation strengthens and extends the provisions of the 1983 Directive in the light of the experience gained.

The Luxembourg law of 3 May 1994 first establishes a legal obligation for credit institutions to submit to a supervision on a consolidated basis in the same way as to a supervision on an stand-alone basis. Consequently, the competences that Article 30 of the law of 20 May 1983 creating an Institut Monétaire Luxembourgeois conferred to the IML for the execution of its supervisory mission shall apply both to the non-consolidated supervision and the consolidated supervision, thus implying the extension of the regulatory requirements to the whole group of related undertakings.

At this stage, a fundamental distinction should be drawn between, on the one hand, the consolidation for the purposes of the institution and the publication of the consolidated accounts, governed by Part III of the law of 17 June 1992 relating to the accounts of credit institutions as well as by Circular IML 92/86 and, on the other hand, the consolidation for the purposes of the prudential supervision exercised by the IML in accordance with the new Articles 48 to 51-1 of the law of 5 April 1993 on the financial sector and this circular.

Thus, the supervision on a consolidated basis, aimed to assess the risks of a banking or financial group, only concerns holdings in 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 this difference in objectives and scope of application, the credit institutions which are exempted, under Circular IML 92/86, to provide consolidated accounts to be published, are nevertheless required, pursuant to the new Article 49(1) to prepare consolidated accounts for prudential supervisory purposes if they are subject to the consolidated supervision of the IML.

The new legislation extends the scope of application of the supervision on a consolidated basis, in particular by submitting to the consolidated supervision a group as soon as it includes a credit institution, whether or not the consolidating undertaking is a credit institution; the new law requires thus a consolidation in the cases where the parent company of a credit institution is a financial company. In the same vein, a group controlled by a mixed-activity company is now subject to the obligation to provide information to the supervisory authorities in order to facilitate the exercise of the supervision of credit institutions which are subsidiaries and to enable an assessment of the global financial situation of the group.

The scope of consolidation is also changed insofar as the threshold for taking into account companies was brought to a lower level of holding; a holding is now defined as the direct or indirect holding of more than 20% of the voting rights or the capital of an undertaking.

It should also be noted that the EU credit institutions can no longer claim a general exemption from the supervision on a consolidated basis. Indeed, the IML can no longer waive the supervision on a consolidated basis in the case where at least 75% of the activities of the credit institution holding the interest are already consolidated with those of another credit institution which is itself subject to a supervision on a consolidated basis by competent authorities of another EU Member State and where the credit institution, in which the interest is held, is included in this supervision on a consolidated basis. Following the provisions

of Directive 92/30/EEC, this option of waiver provided for in former Article 50(1)(a) of the law of 5 April 1993 is no longer included in the new law on consolidated supervision, so that the IML is now required to assume the responsibility for the consolidated supervision on the credit institutions falling within this category.

The law of 3 May 1994 eventually aims to enhance the means at the disposal of the authorities to exercise a prudential supervision on a consolidated basis and to specify the methods to be used within the context of this supervision as well as its content.

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

The credit institutions 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 Annexe of the circular which lists the definitions of a certain number of words used repeatedly and included in the law of 5 April 1993 on the financial sector and the law of 17 June 1992 relating to the accounts of credit institutions, respectively.

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

1.1. Case of a credit institution being a consolidating undertaking

The credit institutions authorised in Luxembourg which have as subsidiaries, in Luxembourg or abroad (EU Member States and third countries) at least one credit institution or financial institution or holding an interest in such institutions are subject to the supervision on a consolidated basis by the IML.

As stated in page 4 of this circular, the credit institutions authorised in Luxembourg can no longer benefit from an exemption for the consolidated supervision to be exercised by the IML by the very fact that they are themselves subsidiaries of a credit institution supervised by a banking supervisory authority of another EU Member State.

1.2. Case of a Luxembourg financial company being a consolidating undertaking

The credit institutions authorised in Luxembourg which are subsidiaries of a parent company established in Luxembourg, which is a financial company pursuant to Article 48, third indent, i.e. a financial institution whose subsidiary/subsidiaries are exclusively or mainly (one) credit institution(s) or financial institution(s), at least one of these subsidiaries being a credit institution, are subject to the supervision on a consolidated basis by the IML. The other professionals of the financial sector and the holding companies holding exclusively or mainly interests in credit institutions fall in particular within this category.

In these cases, the Luxembourg credit institution is subject to a consolidated supervision based on the consolidated situation of the financial company, without the individual financial company being however necessarily subject to the supervision of the IML.

Where the Luxembourg financial company, being a shareholder of the Luxembourg credit institution, is itself held by a credit institution having its registered office in another EU Member State and insofar as the Luxembourg credit institution has no subsidiary or does not hold interests as those referred to in item 1.1. above, the supervision on a consolidated basis is exercised by the banking supervisory authorities which are competent for the supervision of the credit institution which is shareholder of the Luxembourg financial company and not by the IML. If, however, the Luxembourg credit institution has one or several subsidiaries or holds interests to be consolidated, the IML exercises the consolidated supervision downstream of the Luxembourg credit institution pursuant to the provisions of item 1.1. above.

Where a Luxembourg financial company has bank subsidiaries in several EU Member States but not in Luxembourg, the IML and the relevant supervisory authorities agree to

designate the one which will be in charge of the consolidated supervision. The IML 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 (which is not the case for holding companies). In the absence of an agreement between the authorities of the countries where the banking subsidiaries are established, the consolidated supervision is assumed by the authority having given the authorisation to the credit institution which holds the largest balance sheet total which, on equal total balance sheet, is the oldest.

1.3. Case of an EU financial company being a consolidating undertaking

Where a Luxembourg credit institution is a subsidiary of a financial company established in another EU Member State and this financial company has no other banking subsidiary in the EU, the IML exercises the consolidated supervision based on the consolidated situation of the financial company.

Where the financial company which is the parent company of the credit institution governed by Luxembourg law has also a banking subsidiary in the EU Member State in which it is established, the banking supervisory authorities of this State are competent for the exercise of the supervision on a consolidated basis.

In the case where this financial company which is the parent company of a credit institution governed by Luxembourg law has no banking subsidiary in the Member State where it is established, but one or several banking subsidiaries in one or several other EU State(s), the IML 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 banking subsidiaries

are established, Article 49(2)(c) provides that the IML assumes the supervision on a consolidated basis if the credit institution which is a subsidiary authorised in Luxembourg holds the largest balance sheet total which, on equal total balance sheet, is the oldest credit institution of the group.

If the financial company, which is shareholder of the credit institution governed by Luxembourg law, is itself held by a credit institution having its registered office in another EU Member State, the provisions of the third sub-paragraph of item 1.2. above are applicable.

1.4. Case of a non-EU financial company being a consolidating undertaking

In case of banking groups whose head group is located outside the EU, the responsibility of the supervision on a consolidated basis on the subgroup of the undertakings, for which the supervisory authorities of an EU Member State is competent, is determined at the highest level on the EU territory. The authorities responsible for this supervision are determined to apply the principles set out below.

Where the financial company, established on non-EU territory, is the parent company of a Luxembourg credit institution and where the group does not have a credit institution in another EU Member State, the IML exercises the consolidated supervision downstream of the Luxembourg credit institution in accordance with the provisions of item 1.1. above.

In the case where this financial company has moreover one or several banking subsidiaries in one or several other EU States, the IML and the relevant authorities designate, by mutual agreement, that in charge of the consolidated supervision. In the absence of an agreement, the provisions of Article 49(2)c) are applicable (cf. item 1.3. above).

If the financial company, which is shareholder of the credit institution governed by Luxembourg law, is itself held by a credit institution having its registered office in another EU Member State, reference should be made to the provisions of the third sub-paragraph of item 1.2. above.

2. Scope of the supervision on a consolidated basis

2.1. General principle

2.1.1. Types of companies concerned

The scope of the supervision on a consolidated basis, which is not limited to the EU territory, concerns credit institutions and financial institutions.

The following entities are considered as credit institutions:

- 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 EU, 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" shall mean according to this regulation, any undertaking, the principal activity of which is to acquire holdings or to carry on one or more of the businesses referred to in items 2 to 12 of the list included as Annexe I to the law of 5 April 1993 on the financial sector.

The following entities fall within the scope of consolidation without them representing an exhaustive list:

- the holding companies regardless of the composition of their portfolio of holdings, as the scope of consolidation is not limited to holding companies holding financial interests;
- the other professionals of the financial sector as defined in Chapter 2 of the law of 5 April 1993 on the financial sector;
- the management companies of one or several investment funds;
- the investment companies with variable capital;
- the leasing companies carrying out mainly property leasing transactions.

2.1.2. The particular case 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 credit institution or its parent company holds subsidiaries or interests in credit institutions or financial institutions. However, where the ancillary banking services undertakings are the only companies to be consolidated which depend on the credit institution, they do not trigger a consolidated supervision.

2.1.3. Consolidation threshold

The companies referred to in items 2.1.1. and 2.1.2. are to be included in the scope where they are subsidiaries or sub-subsidiaries of the credit institution falling within the scope of application or its parent company which is a financial company in the cases referred to in item 1.2., 1.3. and 1.4. above. Indeed, the subsidiary of a subsidiary shall also be considered as a subsidiary. Moreover, any company referred to in items 2.1.1. and 2.1.2. in which an interest is, directly or indirectly, held of more than 20% of the voting rights or the capital falling 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 50(4) if a credit institution exercises significant influence on one or several credit institutions or financial institutions. The relevant institutions provide the IML with a description of the consolidation methods they intend to apply. The IML determines whether and in what form a consolidation shall be carried out. The same applies in the case where two or more credit institutions 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 authorises the IML to waive its right to include in the scope of the supervision on a consolidated basis, given entities where the conditions mentioned in Article 49(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 necessary information for the exercise of this supervision, the IML does not, in principle, envisage to make 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 company is affected: the IML considers indeed that the latter shall have means enabling to have sufficient influence on the transactions carried out and the risks incurred by the entity in which it holds interests. The necessary information to enable the supervision on a consolidated basis to be exercised by the IML will be thus possible.

In accordance with the provisions of Article 49(4), 2nd and 3rd indents, the IML waives, however, the supervision on a consolidated basis in the cases where it would not be material as

regards the objectives of the supervision of the credit institutions or would be inappropriate due to the nature of the undertaken activities to include in the consolidation companies in which the interest is held.

However, a consolidation should be carried out if the consolidating undertaking holds several interests which, taken on an stand-alone basis, are of negligible importance, but whose balance sheet total exceeds the criteria set, i.e. ECU 10 million or 1% of the balance sheet total of the parent company or the undertaking holding the interest, and insofar as the group of companies is not of negligible importance as regards the aforementioned objectives. This additional clause is an innovation as regards the previous provisions.

It is clear that a waiver on the basis of Article 49(4) will not be valid as long as the grounds on which it is based remain the same. The institution falling within the scope of application is in charge of informing the IML in case of change of the objective pursued by the holding or in case of overrun of the lowest of the two thresholds provided for in the law, i.e. ECU 10 million or 1% of the balance sheet total of the parent company or the undertaking holding the interest. The IML will verify whether the waiver can be maintained or not.

The application of these two cases of waiver by the IML does not prejudice the obligation of the credit institutions to provide information (cf. Chapter V of this circular) on the companies excluded from the consolidation on the basis of the provisions of Article 49(4), 2nd and 3rd indents.

3. Methods of consolidation

3.1. Full consolidation

Pursuant to Article 50(1), the IML 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 when either the parent company holds, directly or indirectly, a majority of the voting rights or the parent company is entitled to appoint a majority of the members of the administration or management bodies, or there is no other majority shareholder or holding a major interest or the parent company holds de facto a majority in accordance with an agreement concluded with other shareholders or members of the undertaking, or 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 of the articles of incorporation.

3.2. Proportional consolidation

The IML supervises on the basis of a proportional consolidation in case of a holding between 20% and 50% according to the provisions of Article 50(2). The proportional consolidation can, moreover, be accepted in case 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 part of the capital and insofar as the suitability of the other shareholders or members fulfils the IML's expectations.

In the case where the consolidating undertaking exerts, in the view of the IML, 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 cases not covered by the aforementioned provisions, but which are nevertheless included in the scope of the consolidated supervision, the IML decides, on a case-by-case basis, which consolidation method shall apply.

III. CONTENT OF THE SUPERVISION ON A CONSOLIDATED BASIS

Article 51 provides that the supervision on a consolidated basis relates at least to:

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

Pursuant to Article 51-1, the IML 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.

1. **Consolidated supervision on a group controlled by a Luxembourg credit institution**

1.1. Supervision of the solvency

The credit institutions which are subject to the supervision of the IML, on a consolidated basis, in accordance with the law on the financial sector shall comply, at all times, with the solvency ratio also on a consolidated basis. The methods for calculating the consolidated solvency ratio are determined by Circular IML 93/93. Any regulation in this regard which will enter into force following this Circular shall also apply on a consolidated basis.

It is worth recalling that the Luxembourg credit institutions which are undertakings falling within the scope of the supervision on a consolidated basis of the IML may, subject to the agreement of the IML, choose not to deduct their holdings in other credit institutions and financial institutions included in the consolidation for the purposes of calculating non-consolidated own funds and the solvency ratio. The holdings in question are then to be included in the risk-weighted assets. The same

treatment is to be applied to subordinated claims and other instruments with the characteristics of capital held in respect of these holdings. This treatment is only permitted in respect of holdings in other credit or financial institutions which are subject, on a stand-alone basis, to compliance with the European solvency ratio or equivalent solvency standards.

The holdings in credit institutions and financial institutions non-covered by the preceding sub-paragraph as well as in ancillary banking services undertakings shall be deducted, according to their net book value (deduction of the value adjustments), own funds of the credit institution for the purposes of calculating the non-consolidated solvency ratio.

1.2. Control of large exposures

The credit institutions falling within the consolidated supervision are required to comply, at all times, with the rules relating to the control of large exposures also on a consolidated basis. They are, moreover, required to notify, on a quarterly basis, the IML of the large exposures they may incur, on a consolidated basis, where these risks are higher than or equal to the lowest of the two following amounts: 10% of the consolidated own funds of the credit institution or LUF 250 million. The instructions as regards the control of large exposures are detailed in Circular IML 94/108; the instructions relating to the notification of large exposures are specified in Chapter 4 of the aforementioned circular. Any future regulation as regards the control of large exposures shall also be complied with on a consolidated basis.

1.3. Market risk

Pending the transposition of the EU Directive on the capital adequacy into Luxembourg regulation, the IML has not yet defined the specific standards regarding the supervision of the

market risk required in this regard. The rules which will enter into force shall apply on a consolidated basis.

1.4. Internal control procedures for the supervision on a consolidated basis

In the interests of a supervision on the basis of an effective consolidation, the Luxembourg credit institutions shall ensure that a sound administrative and accounting organisation and an adequate internal control are in place in their subsidiaries (within the meaning of Article 48, 8th indent) in order, in particular, to guarantee the provision and communication of the information useful for this supervision. The parent companies are thus required to establish a permanent supervision of these companies by one or several responsible persons in Luxembourg and to include them in the audit plan of their internal auditors by submitting them, on a regular basis, to an extended supervision carried out by the latter. Additional comments on the internal audit procedure are offered in a circular to be issued by the IML as regards the internal control.

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

As regards companies in which an interest between 20% and 50% is held, the Luxembourg institution, which is not a parent undertaking, is under the responsibility to strive together with the other shareholders or members concerned to establish an administrative and accounting organisation and an internal control similar to that in place in the Luxembourg institution.

In the case where the aforementioned requirements are not fulfilled and that the situation is not quickly regularised, the Luxembourg institution shall envisage to dispose the holdings in question or at least to reduce them to a level where it will be

no longer required to consolidate for supervisory purposes given that the requirements of Article 51-1(1)(c) of the law of 5 April 1993 cannot be fulfilled.

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

The external audit of the credit institutions subject to the supervision on a consolidated basis of the IML shall be carried out according to the generally accepted working standards for the audit of the consolidated accounts. The audit shall be the subject of a long form audit report of these accounts established according to the same format as the long form report relating to the non-consolidated accounts.

The consolidated long form report shall explicitly state how the management of the group works from the consolidating undertaking as well as the organisation of the subsidiaries and companies with whom there is a shareholding relationship within the meaning of Article 48, 6th indent, of the law of 5 April 1993 and which are included in the scope of consolidation.

When the institution is the parent company, it shall, moreover, ensure that a long form report is established for any fully consolidated subsidiary.

It should finally be noted that the IML recommends to commission a *réviseurs d'entreprises* which assumes, in accordance with the professional standards in this regard, the responsibility for the external audit of the entire group. This recommendation aims to ensure a uniform quality external audit in all entities of the group and to enable the external auditor in charge of the audit to assess the group.

1.6. Management of all undertakings falling within the consolidation and central administrative and accounting organisation

The law of 5 April 1993 as amended by Article 51-1(1) (b) of the law of 3 May 1994 requires that a credit institution subject to the consolidated supervision of the IML 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 consequently aims at the centralising functions. It is superimposed, without, however, displacing them, on the legal requirement at the level of the individual credit institution in Article 5(1) of the law on the financial sector and pursuant to which any credit institution authorised in Luxembourg shall prove the existence in Luxembourg of its central administration, i.e. the decision-making centre and the administrative 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 51-1(1) (b) present similarities with those of the central administration and sound administrative and accounting organisation included in Articles 5(1) and 5(2) of the law of 5 April 1993.

Therefore, a consolidating undertaking, where it is a parent company, cannot simply play a purely administrative role; it shall be a decision-making centre. The definition of the business policy of the group is incumbent upon it as well as the supervision of its application 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 company 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 policy of the group and to ensure, following the adoption by the competent bodies of the parent company, its application. The implementation at group level of decision-making committees is to be planned.

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

The parent company shall centralise all information relating to the group and take charge of their transmission to the supervisory authorities. Pursuant to Article 51-1(1)(c), it shall also ensure the reliability of the consolidated statements to be submitted to the IML and the adequacy of the reporting system.

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

1.7. 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 (Articles 38 and 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 IML shall 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 forbidden in Luxembourg.

Money laundering rules shall be implemented in accordance with item 1.4. above. It should be noted that in the same line as provided for the internal control procedures, the consolidating undertaking shall strive together to implement Luxembourg standards as regards the prevention of money laundering in the companies concerned.

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

1.8. Holdings by subsidiaries

In view of the legal responsibility of consolidated supervision incumbent upon the IML and given Articles 6(2) and 51-1(1)(a) 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 holding by a subsidiary or a sub-subsidiary of a parent company (within the meaning of Article 48, 7th indent, of the law) subject to the consolidated supervision of the IML shall obtain the prior authorisation of the ultimate supervisory authority, i.e. the IML. In this respect, reference is made to the provisions of Article 57 of the law of 5 April 1993 which are thus applicable, by extension, to these holdings.

2. Consolidated supervision on a group controlled by a Luxembourg financial company

It should be borne in mind that the financial company which is a parent company does not, in principle, fall within the individual prudential supervision exercised by the IML. 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 led by a Luxembourg credit institution. The Luxembourg credit institution being part of the group is, in principle, in charge of the compliance with these rules at the group level. The IML, however, reserves the right to address, in the exercise of its consolidated supervision on the group and as far as possible, directly to the financial company which is a parent company. Consequently, the IML recommends that such financial companies which are not subject to its individual supervision should have a sufficient infrastructure enabling them to assume their control function over the group adequately (cf. item 2.4. below).

2.1. Supervision of the solvency

The rules applicable to the groups controlled by a Luxembourg credit institution, set out in Chapter III.1.1. are, in general, also applicable to groups having as parent company a financial company. It should, however, be mentioned that the question whether or not the holdings shall be deducted for the purposes of calculating non-consolidated own funds and the non-consolidated solvency ratio is in this case irrelevant given the absence of obligation for financial companies to comply with such a solvency ratio on a stand-alone basis.

2.2. Control of large exposures

Market risk

Internal control procedures for the supervision on a consolidated basis

The rules referred to in items 1.2., 1.3. and 1.4. of Chapter III are also applicable to the groups controlled by a financial company.

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

2.3. Rules on the audits to be carried out by the *réviseurs d'entreprises*

The external audit of the group subject to the supervision on a consolidated basis of the IML shall be carried out according to the generally accepted working standards for the audit of the consolidated accounts. The audit shall be the subject of a long form audit report of these accounts established according to the same format as the long form report relating to the non-consolidated accounts.

The content of the consolidated long form report shall, by analogy, comply with the rules set out in this respect in item III.1.5. above.

The financial company shall ensure that the long form report is established for any fully consolidated subsidiary. The IML, however, reserves the right to require a separate long form report dealing with the financial company. In any case, the

financial company shall produce for the attention of the IML an audit certificate issued by its auditor.

The recommendation of the IML in respect of the mandate to be conferred to a *réviseurs d'entreprises* who assumes responsibility for the external audit of the entire group, as mentioned in item III.1.5. is also applicable to the groups controlled by a financial company.

2.4. Management of all undertakings falling within the consolidation and the central administrative and accounting organisation

A financial company established in Luxembourg which is at the head of a banking or financial group shall 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 shall 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 shall have a general manager informed of the policy of the group on site in Luxembourg, which has a coordination power on all companies dependent on the group and which acts as contact person of the IML.

In the case where the financial company, which is a parent company, is not established in Luxembourg, the administrative and central accounting organisation, as described above (cf. item III.1.6.) shall be put in place in the Luxembourg credit institution belonging to the group. As regards the management of all undertakings falling within the consolidation, the model shall be discussed, on a case-by-case basis, with the IML as regards what is acceptable in light of the law.

2.5. Prevention of money laundering activities

Reference is made to item III.1.7. which applies by analogy to the financial company, which is a parent company, as well as to the companies included in the consolidated control exercised by the IML.

2.6. Holdings by subsidiaries

Provisions of item III.1.8. also extend to the groups controlled by a financial company.

3. Supervision of a group controlled by a mixed-activity company

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

Moreover, the IML 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 IML 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 are discussed on a case-by-case basis.

IV. POWERS OF THE IML OVER THE ENTITIES SUBJECT TO ITS CONSOLIDATED SUPERVISION**1. Right of the IML to information**

On the basis of Article 51-1(2)(a) and 51-1(2)(c), the IML is entitled to request entities belonging to a banking or financial group subject to its consolidated supervision for all information which it deems necessary for the exercise of this supervision, whether or not these entities are subject to the prudential supervision of the IML on a stand-alone basis or whether or not they are included in the scope of consolidation. In principle, the IML receives this information through the parent company of the group.

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

Pursuant to Article 51-1(4)(a), the institutions are required to communicate the required information to the IML. If there is a refusal to disclose the requested information, the IML may impose the sanctions provided for below. The IML 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 IML, the IML may request, either directly or indirectly through the credit institution 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 company 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 credit institutions which are subsidiaries, whereas in the case of a parent company 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 IML will simply request information relating to the financial part of the group. The structure of the group shall thus enable to clearly separate the financial part from the rest of the group. If not, a groups' restructuring may be necessary.

Moreover, the IML 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 IML reserves the right to request, within the context of its competences, information on 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 an 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 on a consolidated basis of the group.

2. Sanctions

2.1. Case of a parent company supervised by the IML

In case of a refusal by an institution subject to the prudential supervision of the IML on a stand-alone basis to disclose the requested information, the IML may apply towards this institution the sanctions provided for by the law of 5 April 1993 on the financial sector within the context of the non-consolidated prudential supervision from the injunction and suspension to the issue of administrative sanctions (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 51-1(1)(a), the IML has the legal power to refuse certain group structures deemed inappropriate. Indeed, given that any qualifying holding is subject to prior authorisation by the IML provided for in Article 57(1) of the law of 5 April 1993 on the financial sector, the IML may reject 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.

2.2. Case of a parent company not supervised by the IML

In the case where an undertaking, which is not subject, on a stand-alone basis, to the prudential supervision of the IML and which is the parent company of at least one Luxembourg credit institution, does not provide the IML with the requested information, the latter may, in accordance with Article 51-1(5) of the law of 5 April 1993, issue injunctions and administrative fines against the entity in question.

If the injunction is not applied within the period set, the IML may draw the conclusion that the suitability of the shareholder of the group to which the credit institution belongs does no longer guarantee a sound and prudent management of the credit institution and does no longer fulfil the banking authorisation conditions provided for in Article 6(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 IML may acknowledge that Article 6(2) of the law of 5 April 1993 is not complied with by the credit institution governed by Luxembourg law as it belongs to a non-transparent group or whose parent company objects to an adequate supervision on a consolidated basis.

V. PRATICAL REQUIREMENTS

1. Consolidated information to be provided by a group controlled by a credit institution

The consolidating credit institutions shall communicate the following information to the IML:

1.1. on a quarterly basis

- an active and passive consolidated situation with off-balance sheet (IML table 6.1);
- consolidated profit and loss account (IML table 6.2);
- information on the consolidated risk concentration (IML table 6.3);
- a consolidated solvency ratio calculated in accordance with the rules and methods defined by Circular IML 93/93 relating to the solvency ratio (IML table IML 6.4);

1.2. on an annual basis

- a final active and passive consolidated situation with off-balance sheet (IML table 7.1);
- final consolidated profit and loss account (IML table 7.2);
- an audit report of the external auditors relating to the annual accounts of each company entirely included in the consolidation;
- an annual report (or in its absence the annual accounts) relating to each company included in the consolidation;
- a long form audit report on the consolidated accounts.

The consolidated financial statements are established by the institution subject to the consolidated supervision of the IML and shall encompass the situation of the consolidating institution and, either fully or proportionally or according to another method, that of the companies to be consolidated.

Consequently, the consolidating institution shall centralise all information relating to the group and take charge of their transmission to the IML. Pursuant to Article 51-1(1)(c), it shall also ensure the reliability of the consolidated financial statements to be submitted to the IML.

The IML shall receive the information at the latest two months after the end of each quarter.

As regards the undertakings for which the IML waived consolidation in accordance with Article 49(4), 2nd and 3rd indents, the parent company shall provide the IML with a copy of the annual report on an annual basis (or in its absence the annual accounts) relating to each company.

It should be specified that these instructions do, in no way, alter the rules applicable to the non-consolidated information.

1.3. Long form audit report

The IML shall receive the long form audit report relating to the consolidated accounts established according to the same rules as those of the report relating to the non-consolidated accounts, on an annual basis, at the latest three months after the general meeting.

2. Consolidated information to be provided by a group controlled by a financial company

2.1. Case of a Luxembourg financial company which is a parent company

The Luxembourg financial companies which are parent companies shall inform the IML of the information of the same nature as those required from the groups headed by a credit institution. For more details, reference should be made to items 1.1. and 1.2. of this chapter.

2.2. Case of a non-Luxembourg financial company which is a parent undertaking

The nature as well as the periodicity of the reports to be provided to the IML by groups controlled by a non-Luxembourg financial company will be defined by the IML on a case-by-case basis.

3. Information to be provided by a group controlled by a mixed-activity company

The nature as well as the periodicity of the reports to be provided to the IML by groups controlled by a mixed-activity company will be defined by the IML on a case-by-case basis.

4. List of companies included in the scope of the supervision on a consolidated basis

All credit institutions are required to provide the IML, at the latest on 29 February 1996, with a list established on 31 December 1995 and including the companies in which they hold an interest as well as the other companies referred to in item II.2.1.3., 2nd sub-paragraph, in order to enable the IML to

acknowledge whether the provisions relating to the scope of the consolidated supervision are properly applied. 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 ...);
- the balance sheet total of the company (if Article 49(4), 2nd indent is invoked);
- a precise indication of the activities of the company;
- the method of 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 credit institutions shall inform the IML of any change of the data included in the aforementioned list. The same information are also to be communicated to the IML prior to any new holding.

Yours faithfully,

INSTITUT MONETAIRE LUXEMBOURGEOIS

Jean GUILL
Director

Jean-Nicolas SCHAUS
Director

Pierre JAANS
Director General

ANNEXE: DEFINITIONS

Financial company: a financial institution the subsidiary undertakings of which are either exclusively or mainly one or mainly credit institution(s) or other financial institutions, one of the subsidiaries at least is a credit institution;

Mixed-activity company a parent company other than a financial company or a credit institution which, among its subsidiaries, has at least a credit institution;

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 as the majority of the shareholders' or members' voting rights of another undertaking; or
- is entitled to appoint or to dismiss the majority of the members of an undertaking's administrative, management or supervisory body and is, at the same time, a shareholder or partner 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 IML, 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 UE, 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, the principal activity of which is to acquire holdings or to carry on one or more of the activities referred to in items 2 to 12 of the list included as Annexe I to the law of 5 April 1993 on the financial sector;

Subsidiary: an undertaking in respect of which a parent company

- has the majority of the shareholders' or members' voting rights; 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 company actually exercises, in the view of the IML, a dominant influence;
- any subsidiary undertaking of a subsidiary undertaking shall also be considered as the subsidiary of the undertaking that is their original parent;

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 of the articles of incorporation;

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