



Public hearing  
EBA Draft RTS on the methods of prudential  
consolidation under Article 18 of the CRR

London, 22 January 2018

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# Background

# Background: Legal basis

## Article 18(7) of the CRR

- ‘EBA shall develop draft regulatory technical standards to specify conditions according to which consolidation shall be carried out in the cases referred to in paragraphs 2 to 6’ of Article 18 of the CRR.
- Deadline: The EBA shall submit those draft RTS to the Commission by 31 December 2016. However, the EBA informed the Commission that it will deliver on this mandate on a later date to consider the work being carried out by the Basel Committee (BCBS) on identification and management of step-in risk.
- The Commission published on 23 November 2016 the CRR II/ CRDV proposal which includes some amendments to the current Article 18 of the CRR. The CRR II/CRD IV is currently being discussed at Council and Parliament level. The draft RTS have been drafted taking into consideration the current CRR text.

# EBA draft RTS

# EBA draft RTS: Structure (1/2)

<p><b>Title I: Subject matter, scope of application and definitions</b></p>	<ul style="list-style-type: none"> <li>• Article 1: Subject matter and scope of application</li> <li>• Article 2: Definitions</li> </ul>
<p><b>Title II: Permission for proportional consolidation of subsidiaries under Article 18(2) of the CRR</b></p>	<ul style="list-style-type: none"> <li>• Article 3: Application for permission to use proportional consolidation</li> <li>• Article 4: Permission to apply proportional consolidation</li> <li>• Article 5: Contract limiting the liability of the shareholders of members</li> <li>• Article 6: Changes in the shareholders' or members' contract</li> <li>• Article 7: Requirements relating to the solvency of other shareholders or members</li> </ul>
<p><b>Title III: Consolidation of undertakings managed on a unified basis or by the same persons under Article 18(3) and Article 18(6)(b) of the CRR</b></p>	<ul style="list-style-type: none"> <li>• Article 8: Determination of the consolidating entity in case of groups of undertakings managed on a unified basis or by the same persons</li> <li>• Article 9: Method of prudential consolidation</li> </ul>
<p><b>Title IV: Proportional consolidation of undertakings with limited liability under Article 18(4) of the CRR</b></p>	<ul style="list-style-type: none"> <li>• Article 10: Conditions to apply proportional consolidation</li> </ul>
<p><b>Title V: Treatment of other participations or capital ties under Article 18(5) of the CRR</b></p>	<ul style="list-style-type: none"> <li>• Article 11: The prudential treatment of other participations or capital ties under article 18(5) of the CRR</li> </ul>

# EBA draft RTS: Structure (2/2)

<p><b>Title VI Consolidation of undertakings where there is significant influence or the undertakings are under single management under Article 18(6) of the CRR</b></p>	<ul style="list-style-type: none"> <li>• Article 12: Meaning of significant influence under Article 18(6)(a) of the CRR</li> <li>• Article 13: Meaning of placed under single management other than pursuant to a contract or clauses of their memoranda or articles of association under Article 18(6)(b) of the CRR</li> <li>• Article 14: Method of consolidation where significant influence is deemed to exist</li> <li>• Article 15: Method of consolidation where two or more institutions or financial institutions are placed under single management</li> </ul>
<p><b>Title VII Inclusion of capital instruments owned by natural or legal persons other than the undertakings included in the consolidation</b></p>	<ul style="list-style-type: none"> <li>• Article 16: Consolidated Common Equity Tier 1, Additional Tier 1 and Tier 2 capital owned by natural or legal persons other than the undertakings included in the prudential scope of consolidation</li> </ul>
<p><b>Title VIII: Entry into force</b></p>	<ul style="list-style-type: none"> <li>• Article 17: Entry into force</li> </ul>
<p><b>Accompanying documents</b></p>	<ul style="list-style-type: none"> <li>• Draft cost-benefit analysis / impact assessment</li> <li>• Overview of the questions for consultation</li> </ul>

# Main elements: Scope of prudential consolidation

- **Scope and methods of prudential consolidation: Articles 11 and 18 of the CRR**
  
- **Entities included in the scope of prudential consolidation:**
  - Institutions (credit institutions and investment firms);
  - Financial institutions - as defined in point (26) of Article 4(1) of the CRR; and
  - Ancillary services undertakings – as defined in point (18) of Article 4(1) of the CRR, when consolidated supervision is required pursuant to Article 111 of Directive 2013/36/EU.
  
- **The draft RTS include two questions on the scope of application**
  - The application of the definition of financial institution and ancillary services undertakings.
  - Consideration of Securitisation SPEs for accounting and prudential purposes.

The EBA published at the same time as the RTS an Opinion and a Report on the prudential treatment of other financial intermediaries (OFIs) and regulatory perimeter issues



# Main elements: Article 18(1) and (2) of the CRR

## *Article 18(1) of the CRR – General rule*

- Full consolidation of all institutions and financial institutions that are subsidiaries or, where relevant the subsidiaries of the parent financial holding company or mixed financial holding company.
- **However, Article 18(2) of the CRR provides an exception to the general rule**
  - Proportional consolidation of a subsidiary allowed, subject to the permission of the relevant competent authority on a case-by-case basis, upon application from the supervised entity. Proportional consolidation can be applied if certain conditions are met.

## *Draft RTS*

- Provide additional specifications on these conditions to ensure that this permission is given on exceptional cases and based on sound evidence. Institutions should request permission from the competent authority in written form and the application shall be accompanied by appropriate supporting documentation.
- No relevant evidence on the use of this exception.
- CRR review - Proposal to remove this exception.

# Main elements: Article 18(3) of the CRR

## *Article 18(3) of the CRR*

- Undertakings managed on a unified basis pursuant to a contract, memorandum or articles of association; or undertakings whose administrative, management or supervisory bodies consist in the majority of the same persons in office during the financial year and until the consolidated financial statements are drawn up.

## *Draft RTS*

### ▪ **Method of consolidation**

- Aggregation method following the rules of the Accounting directive (2013/34/EU): Paragraphs 8 and 9 of Article 22.

### ▪ **Rules to determine the consolidating entity** – entity responsible to comply with the requirements of the CRR on a consolidated basis:

- Criteria developed taking into consideration Article 111 of the CRD for the determination of the consolidating supervisor.

### ▪ **External shareholders** – do not comply with the definition of minority interest.

- Some limitations included on the recognition of external shareholders in line with the minority interest rules.

# Main elements: Article 18(4) of the CRR

## *Article 18(4) of the CRR*

- Application of proportional consolidation where participations held in institutions and financial institutions are managed together with other non-consolidated undertakings.
  - ▶ Proportional consolidation is mandatory.

## *Draft RTS*

- Specifies the conditions that shall be met to apply proportional consolidation – Based on the criteria included in IFRS 11 Joint Arrangements which, among others, requires unanimous consent of the parties sharing control (for instance, joint ventures according to IFRS).
- Application of proportional consolidation – may result in a divergence from the accounting treatment.
  - ▶ IFRS 11: for joint ventures the equity method is required.

# Article 18(5) of the CRR

## *Article 18(5) of the CRR*

- Competent authorities shall determine whether and how consolidation is to be carried out in case of participations or capital ties other than those referred to in paragraphs 1 and 4 of Article 18 of the CRR (subsidiaries and joint ventures).

## *Draft RTS*

- Develop the application of this paragraph of the CRR and also introduce the indicators of the BCBS guidelines on identification and management of step-in risk.

## *BCBS Guidelines on identification and management of step-in risk (October 2017)*

- The BCBS Guidelines include several indicators that banks should use in identifying entities bearing step-in risk for the bank.
- However, there are differences between the draft RTS and the BCBS Guidelines:
  - ▶ Scope: The draft RTS is limited to institutions, financial institutions and ancillary services undertakings (Q&A 2013\_382 and Q&A 2013\_383).
  - ▶ Pillar I versus Pillar II approach: The draft RTS follow a Pillar I approach. However, references in the background and recitals to the need to consider step-In risk in the ICAAP and SREP.

## Main elements: Article 18(5) of the CRR (cont'd)

### *Draft RTS*

- Competent authorities shall determine the appropriate method of consolidation on a case-by-case basis. However, this does not preclude the possibility for the determination of a general consolidation method (for instance, a competent authority may decide to follow on a general basis the accounting treatment for participation on associates for prudential purposes – i.e. the equity method).
- The determination of the method of consolidation on a case-by-case basis would be relevant to address step-in risk as an ad-hoc prudential treatment may be needed for some undertakings.
- Provide the possibility to competent authorities to review the valuation method of entities outside the scope of prudential consolidation (for example, insurance undertakings or commercial entities) which are fully or proportionally consolidated for accounting purposes but are de-consolidated for prudential purposes.

# Main elements: Article 18(6) of the CRR

## *Article 18(6) of the CRR*

- Competent authorities to determine whether consolidation is required in case of:
  - a) Significant influence without a participation or other capital ties; and
  - b) Single management other than pursuant a contract, memorandum or articles of association.

## *Draft RTS*

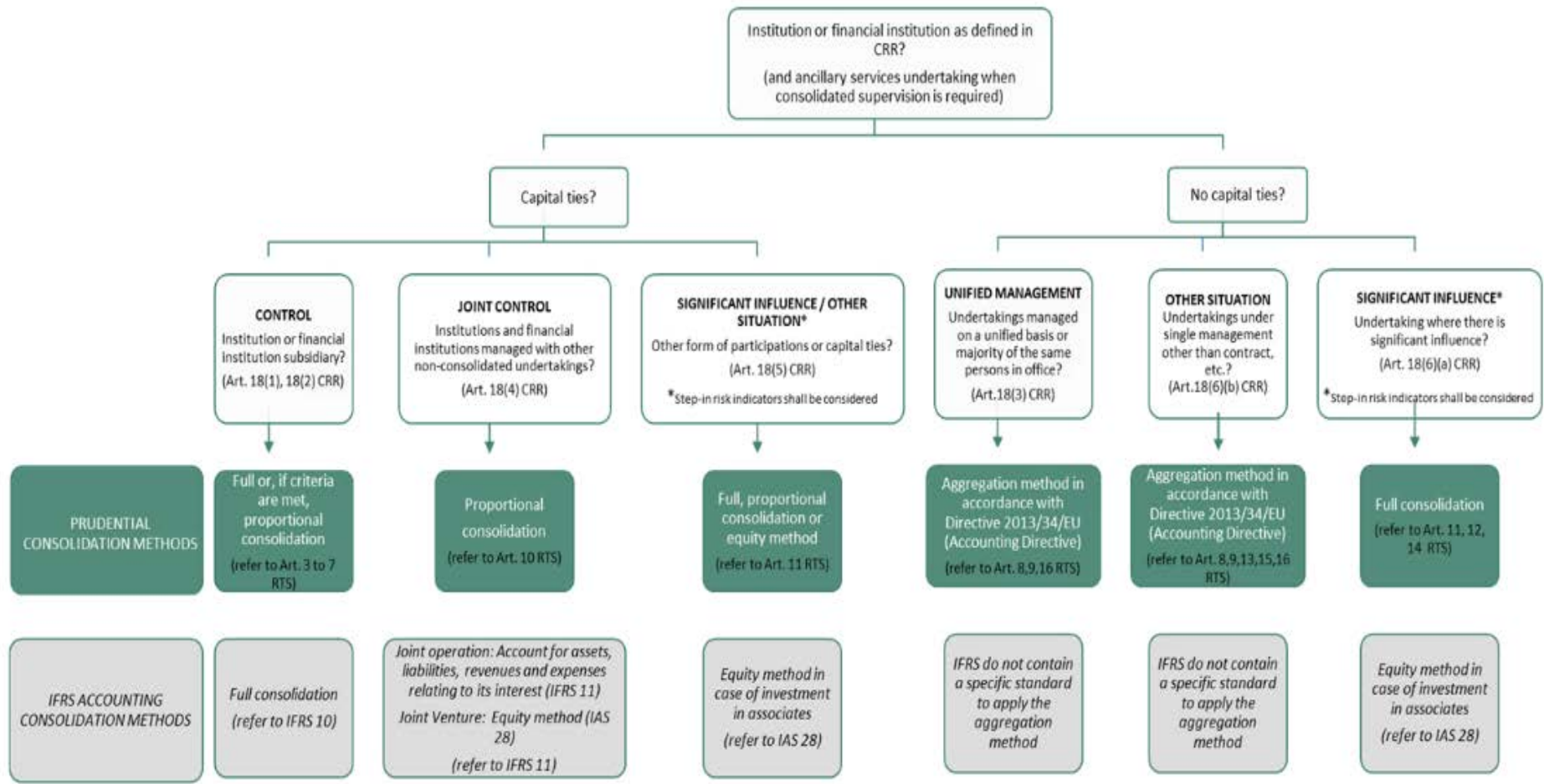
- Provide a prudential definition of significant influence which is based on the criteria established in the accounting standards.
- The indicators on step-in risk introduced in the Articles of the draft RTS developing Article 18(5) of the CRR also need to be considered in the case of significant influence.
- Article 18(6)(b) similar to Article 18(3) of the CRR - A contract, or a memorandum or articles of association not required in Article 18(6)(b).
  - ▶ The prudential treatment proposed is the same than in Article 18(3) of the CRR (i.e. the aggregation method).

## Main elements: Consolidated Additional Tier 1 and Tier 2 capital issued by undertakings that are proportionally consolidated

### *Draft RTS*

- The draft RTS establish the prudential treatment of Additional Tier 1 and Tier 2 capital issued by undertakings which are proportionally consolidated.
- Article 82 of the CRR defines qualifying additional Tier 1, Tier 1, Tier 2 capital and qualifying own funds referring only to subsidiaries.
- The draft RTS clarify that Additional Tier 1 and Tier 2 capital issued by undertakings that are proportionally consolidated can be included as part of total capital.

# Summary of the draft RTS





# Next steps

## Next steps: Timeline



# Next steps: Key Questions

<p>Subject matter and scope of application</p>	<p><b>Q1.</b> Are there undertakings which do not comply with the definition of a financial institution or ancillary services undertaking of Regulation (EU) 575/2013 which should be included in the prudential scope of consolidation? Please explain and provide examples of these entities.</p> <p><b>Q2.</b> Do you consider SSPEs financial institutions? When SSPEs are consolidated for accounting purposes, do you also consolidate them for prudential purposes? Please differentiate in your answer between the situation when SRT is met and when it is not met (the institution originates the securitisation); and when the institution acts as an investor on the securitisation vehicle (whether this is a SSPEs or a special purpose entity used to set up securitisations) or sponsors the securitisation transaction.</p>
<p>Permission for proportional consolidation of subsidiaries under Article 18(2) of the CRR</p>	<p><b>Q3.</b> Do you currently use the method of proportional consolidation for the consolidation of subsidiaries in accordance with Article 18(2) of Regulation (EU) No 575/2013? If proportional consolidation is used, please explain if the conditions included in this Consultation Paper are met.</p> <p><b>Q4.</b> Do you have any comments on the conditions established in this Consultation Paper to apply proportional consolidation pursuant to Article 18(2) of Regulation (EU) No 575/2013?</p>
<p>Consolidation of undertakings managed on a unified basis or by the same persons under Article 18(3) and Article 18(6)(b) of the CRR</p>	<p><b>Q5.</b> Do you agree on the criteria for the determination of the consolidating entity? Do you experience a different situation currently?</p> <p><b>Q6.</b> Do you have any comment on the elements included in this Consultation Paper for the application of the ‘aggregation method’ pursuant to Articles 18(3) and (6)(b) of Regulation (EU) No 575/2013? Please explain.</p>

## Next steps: Key Questions

<p>Proportional consolidation of undertakings with limited liability under Article 18(4) of the CRR</p>	<p><b>Q7.</b> Do you have any comment on the application of proportional consolidation according to Article 18(4) of Regulation (EU) No 575/2013?</p>
<p>Treatment of other participations or capital ties (including equity method) under Article 18(5) of Regulation (EU) No 575/2013</p>	<p><b>Q8.</b> Do you have any comments on the criteria established in this Consultation Paper on the prudential treatment of other participations or capital ties (including the equity method) under Article 18(5) of Regulation (EU) No 575/2013? Please explain.</p>
<p>Draft cost-benefit analysis / impact assessment</p>	<p><b>Q9.</b> Do you agree with the impact assessment and its conclusions? Please provide any additional information regarding the costs and benefits from the application of these draft RTS.</p>
<p>Other comments</p>	<p><b>Q10.</b> Please provide any additional comments on the Consultation Paper.</p>



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