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Circular 04/2018 (VA) – Financial Conglomerate Solvency

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Reporting Financial Conglomerate Solvency

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1 Objective of the Circular

1 This Circular, which has been prepared in collaboration with the Deutsche Bundesbank, provides guidance on the information to be reported to BaFin and the Deutsche Bundesbank (and possibly also to the ECB) in accordance with section 17 (2) sentence 2 of the Financial Conglomerates Supervision Act (*Finanzkonglomerate-Aufsichtsgesetz – FKAG*) to demonstrate capital adequacy at the level of a financial conglomerate.

2 The Financial Conglomerates Solvency Regulation (*Finanzkonglomerate-Solvabilitäts-Verordnung – FkSolV*) dates back to 20 September 2013 and is based on the legal position prior to the effective date or transposition of Regulation (EU) No. 575/2013 (*CRR*) and Directive 2013/36/EU (*CRD IV*) for the banking and investment services sector on the one hand, and Directive 2009/138/EC (*Solvency II*), and acts building upon it, for the insurance sector on the other. These European reform packages have resulted in far-reaching changes in banking and insurance supervisory law.

In addition, Commission Delegated Regulation (EU) No. 342/2014 (*RTS*) specifies in greater detail the three technical calculation methods in Annex I to Directive 2002/87/EC (*FICOD*) as well as other requirements, e.g. on eliminating multiple gearing, on the transferability of own funds or on the deduction of equity holdings in other financial sectors. In light of these far-reaching changes to items of own funds, classification, eligibility limits and solvency requirements, the fair value-based revaluation of balance sheet items under Solvency II and the RTS, the FkSolV was withdrawn by the [Regulation of 6 February 2018](#) (Federal Gazette AT 9 February 2018 V1).

3 The supervisory authorities are gathering initial experience with the CRR/CRD IV and Solvency II supervisory systems as well as their interactions at the level of financial conglomerates. Equally, the concrete impact of the RTS on the calculation of financial conglomerate solvency needs further monitoring. Finally, the FICOD is being continuously updated at the European level.

4 The template for reporting financial conglomerate solvency that has been newly developed by BaFin in collaboration with the Deutsche Bundesbank is therefore being made available for a transitional period to the superordinate undertakings of a financial conglomerate required by section 17 (2) sentence 2 of the FKAG to submit reports. The template replaces the previous reporting templates under section 10 and Annexes 1–8 of the FkSolV.

2 Scope

5 The Circular addresses the additional supervision of financial conglomerates with regard to their capital adequacy. Its scope covers all entities of a financial conglomerate required to be included in the calculation of its own funds in accordance with section 18 (1) of the FKAG.

3 Technical principles

6 Financial conglomerate solvency shall be calculated by the superordinate undertaking of the financial conglomerate on the basis of the technical calculation methods and technical principles set out in the following and defined in greater detail in the RTS, using the template contained in the Annex.

3.1 The technical calculation methods

7 Three possible technical calculation methods are specified for calculating financial conglomerate solvency: the “Accounting consolidation” method (method 1), the “Deduction and aggregation” method (method 2) and the “Combination” method (method 3), in which methods 1 and 2 can be combined.

8 If the financial conglomerate is headed by a regulated entity that is authorised in Germany, the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*) (BaFin) – or for significant banking-led conglomerates the European Central Bank (ECB) under the Single Supervisory Mechanism (SSM) – shall determine which technical calculation method shall be applied, after having heard the superordinate undertaking. The same shall apply if the financial conglomerate is headed by a mixed financial holding company and all supervised entities in the financial conglomerate have their registered office in Germany. If not all of the supervised entities have their registered office in Germany in this case, any of the three methods can be applied. The technical calculation method shall be applied consistently over time.

9 If financial conglomerate solvency is calculated using method 1, the difference between the eligible own funds calculated on the basis of the consolidated financial statements and the solvency requirement at conglomerate level shall be greater than or equal to zero. The German GAAP consolidated financial statements shall be adjusted to conform to the prudential scope of consolidation in order to avoid the consolidation of subsidiaries outside the financial sector. In addition, the assets and liabilities of entities in the insurance sector shall be measured in accordance with Solvency II. This constitutes an exception to the principle of calculating own funds on the basis of the German GAAP consolidated financial statements set out in Article 14 (1) of the RTS. The solvency requirement at conglomerate level is the sum of the solvency requirements for each different financial sector represented in the group, taking into account the adjustments set out in Article 14 (11) of the RTS. The solvency requirements for the individual financial sectors shall be calculated in accordance with the relevant sectoral rules.

10 If financial conglomerate solvency is calculated using method 2, the difference between the sum of own funds of each entity in a financial conglomerate to be included in the

calculation and the solvency requirements for those entities, as well as the carrying amount of the equity holdings in other entities of the group, must be greater than or equal to zero. The solvency requirements for the entities in a financial conglomerate consist of the solvency requirements for all entities to be included in the calculation, calculated in accordance with the relevant sectoral rules. The formula in the Annex to the RTS shall be applied.

11 Certain conditions set out in Article 16 of the RTS apply to the calculation of financial conglomerate solvency using the Combination method (method 3). If these conditions are satisfied, its use may be permitted by BaFin. If an insurance group that is part of a financial conglomerate is allowed to use method 3 for calculating the solvency of the insurance group, the reasons for this should also be taken into consideration when assessing the eligibility of method 3 for the purposes of calculating financial conglomerate solvency.

3.2 Key principles

12 If a subsidiary has a solvency deficit in accordance with the sectoral rules, or if a non-regulated entity has a notional solvency deficit, the deficit shall be fully included at conglomerate level unless BaFin (or the ECB under the SSM) allows it to be included proportionately because the liability of the parent entity is limited to its share of the capital of the subsidiary.

13 Irrespective of the technical calculation method, the multiple use of eligible own funds of the various entities of a financial conglomerate included in the calculation and calculated in accordance with the relevant sectoral rules shall be precluded. When values from the insurance sector are used, it shall be ensured in this respect that the own funds of the entities in other financial sectors are also included when the insurance group solvency is calculated in accordance with the Solvency II supervisory regime under Article 329 (1) of Commission Delegated Regulation (EU) No. 2015/35 ([DR SII](#)). However, at the level of the financial conglomerate, such own funds should be reported in the column for the banking and investment services sector, and not as own funds relating to the insurance sector (exception: own funds of *Pensionskassen* should be allocated to the column for insurance undertakings). Additionally, own funds resulting from intra-group transactions may not be used to cover the solvency requirement at conglomerate level. In addition to own funds from intra-group investments, this excludes in particular subordinated liabilities between entities of a financial conglomerate.

14 In accordance with Article 4 (1) of the RTS, items of own funds of individual member entities of the financial conglomerate that, in principle, can be considered for risk cover in the conglomerate because they exceed the sectoral solvency requirements, may only be recognised at the level of the financial conglomerate if it can be demonstrated that there are no legal, supervisory, contractual, practical or other barriers to their transferability. The items of own funds must be transferable both between individual regulated entities of a financial sector and outside the financial sector to which the entity concerned belongs. Including in cases where method 1 is used, this makes it necessary to determine the transferability of the own funds of the individual entities of a financial conglomerate included in consolidated financial statements, at least at an aggregate level or by using corresponding separate accounts. The availability and transferability shall be confirmed to BaFin and the Bundesbank (or to the ECB as well in the case of the SSM) and, if possible, documented by submitting corresponding calculations. This shall include evidence of measures to mitigate the risk that a transfer of own funds will materially impair the solvency of the transferring entity. Doubts about the transferability of own funds between the financial sectors with regard to different time windows in which an item of own funds

must be available in order to offset losses should be discussed with the supervisory authority.

15 A notional solvency requirement and a notional own funds requirement shall be determined for non-regulated financial sector entities within the meaning of section 2 (3) of the FKAG and included in the calculation at conglomerate level. Where a mixed financial holding company has a holding in a non-regulated financial sector entity, the notional values shall be calculated in accordance with the sectoral rules of the most important sector in the financial conglomerate. Failing that, the notional solvency requirements and the notional own funds shall be calculated in accordance with the rules of the closest sector of the non-regulated entity. In case of doubt, the rules of the most important sector in the financial conglomerate shall be applied.

16 In accordance with Article 329 (1) of the [DR SII](#), the solvency requirements of entities of other financial sectors shall be included in the calculation of insurance group solvency in accordance with the Solvency II supervisory regime. Accordingly, it must be ensured when aggregating the sectoral solvency requirements at conglomerate level that the solvency requirements for related entities in the banking and investment services sector are not double-counted.

4 Reporting period

17 The calculation of financial conglomerate solvency shall be submitted once a year to BaFin and the Deutsche Bundesbank – and to the ECB as well for significant banking-led conglomerates.

18 The report shall be submitted without undue delay following the issuance of the audit report by the auditor for the last financial statements to be included in the calculation and audited (in the case of insurance undertakings following issuance of the opinion on the solvency statement in accordance with section 35 (2) of the German Insurance Supervision Act (*Versicherungsaufsichtsgesetz – VAG*)), and in any event nine months after the end of the superordinate undertaking's financial year.

5 Reporting procedure

19 The superordinate undertaking within the meaning of section 12 of the FKAG shall submit the calculation using the template specified in the Annex to this Circular.

20 One copy of the template shall be submitted to each of BaFin and the responsible Deutsche Bundesbank Regional Office (and also to the ECB under the SSM).

21 The values shall be stated in millions of euros, rounded to three decimal points (example: EUR 167.3 million = 167.300), with percentages rounded to two decimal points (example: 7.1% = 7.10%).

22 The template shall be used irrespective of the chosen technical calculation method. It is divided into three parts: Part A: Own funds, Part B: Solvency requirement at conglomerate level, Part C: Adequacy of own funds of the financial conglomerate.

5.1 The parts of the reporting template

23 Part A is subdivided into items of own funds of the various quality classes, starting with the highest quality. The items of basic own funds in quality class 3 and the items of ancillary own funds in quality classes 2 and 3 that are only defined in the insurance sector play only

a minor role in practice. A further breakdown of those items of own funds is therefore not specified.

24 Part B calculates the solvency requirement at conglomerate level. The solvency requirements of the individual financial sectors are calculated in accordance with the provisions of the relevant sectoral rules. For entities in the banking and investment services sector, the solvency requirement is composed of the Pillar 1 own funds requirement in accordance with Article 92 of the CRR in conjunction with sections 10 and 10a of the German Banking Act (*Kreditwesengesetz* – KWG) and Pillar 2 supplementary own funds requirements in accordance with section 25a of the KWG, including a capital add-on resulting from the internal capital adequacy assessment process and the combined buffer requirement in accordance with section 10i of the KWG. By contrast, the solvency requirements for entities in the insurance sector calculated in accordance with sections 96ff. or sections 250ff. of the VAG consists of the solvency capital requirement and any capital add-ons imposed by the supervisory authority. The overall solvency requirement calculated as part of the own risk and solvency assessment is not relevant for the solvency requirement at conglomerate level.

25 For banking-led or investment-led financial conglomerates, the own funds requirements of investments in an entity in the insurance sector are deducted from the solvency requirement at conglomerate level in part B.3 if the former are deducted from the own funds of the financial conglomerate level in accordance with Article 14 (3) or Article 15 (3) of the RTS. The deduction shall be presented in an annex and explained.

26 Various items are deducted from own funds. The own funds of the financial conglomerate are adjusted in part C.1 for those items of own funds that may not be used to cover the solvency requirement at conglomerate level on the basis of the provisions of the RTS. This relates in the first instance to multiple gearing or own funds resulting from intra-group transactions (see 13 above). In addition, own funds not transferable between entities of the financial conglomerate or between the financial sectors are deducted (see 14 above), as well as any surplus sector-specific own funds that are not available to cover risks in other financial sectors. This is verified in greater detail in part C.2. If method 1 is used, the unconsolidated investments of a banking-led or investment-led financial conglomerate in entities in the insurance sector are deducted in accordance with Article 14 (2) of the RTS, or Article 14 (3) of the RTS in all other cases. The deductions designated in Article 15 (1) to (3) of the RTS are applied if method 2 is used. If further deductions from the eligible own funds at conglomerate level are necessary, they shall be explained separately.

27 Part C.2 is used to verify compliance with the requirements of Article 5 of the RTS, under which sector-specific own funds may only be used cover risks in that financial sector.

28 As the result of the preceding parts, part C.3 presents the capital adequacy of the financial conglomerate. If method 1 is used, it is necessary to confirm that the thresholds or limits referred to in Article 14 (7) of the RTS are observed. If this is not the case, a separate explanation is required. For the insurance sector, this refers to the quantitative limits set out in section 94 of the VAG that are described in greater detail in Article 82 (1) and (3) of the DR SII. If method 2 is used, the sector-specific thresholds or limits are already taken into account at the level of the individual entities of the financial conglomerate.

5.2 The columns of the reporting template

29 Columns 1 and 2 are populated to reflect the source of the own funds or solvency requirements for individual financial sectors (insurance or banking and investment services). The total is then entered in column 3.

30 If possible, columns 1 and 2 should also be populated if method 1 is used, provided that the source of the relevant items can be allocated to one of the two financial sectors (using a separate account if necessary). If this is not possible because consolidated values are used, only column 3 can be populated.

31 Because of the difference between the financial conglomerates and the technical calculation methods used, it may make sense to supplement the reporting template with entity-specific information. Provided that the structure and predefined rows and columns remain unchanged and are used appropriately, BaFin and the Bundesbank will allow additional fields/comments/separate accounts to be added. These additional data fields must be clearly identified as being entity-specific by the use of different colours. By expressly allowing these entity-specific adjustments, BaFin and the Bundesbank accept that open questions of interpretation may arise as the basis of a learning curve.

32 Entities that belong to other financial sectors from the perspective of Solvency II (see Article 329 (1) of the DR SII) are viewed by the FKAG as being largely members of the banking and investment services sector, and are correspondingly allocated to column 1 of the reporting template. Only *Pensionskassen* belong to the insurance sector because they are life insurance undertakings and are recorded in column 2. In line with section 18 (1) of the FKAG, *Pensionsfonds* are not part of the prudential scope of consolidation of a financial conglomerate.

6 Relationship with group solvency under Solvency II

33 Under Article 335 and Article 336 of the DR SII, the consolidation method in accordance with sections 261 to 264 of the VAG already includes the proportionate share of the own funds and own funds requirements of group entities in other financial sectors. Although there is no (full) consolidation, Solvency II thus adopts a cross-sectoral perspective to a certain extent. This is reflected in Article 8 of the RTS, which sets out that the consolidation method for insurance-led financial conglomerates is equivalent to method 1 if the scope of group supervision is not materially different from the scope of supplementary supervision.

34 The requirements and scope of Article 8 of the RTS run into difficulties in practice. BaFin is seeking clarification at European level as to how the own funds and capital requirements of entities in other financial sectors are to be included in insurance group solvency. The conditions for and consequences of the equivalence suggested in Article 8 of the RTS also need to be clarified in this connection. Until this issue has been finally resolved, insurance-led financial conglomerates should also continue to report their financial conglomerate solvency using the new reporting template to enable a comparison of the differences to insurance group solvency in the first place.