

**Final Report**

**on**

**Public Consultation No. 14/036 on**

**Guidelines on treatment of related**

**undertakings, including participations**

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# 1. Executive summary

## Introduction

According to Article 16 of Regulation (EU) No 1094/2010 (EIOPA Regulation) EIOPA may issue guidelines addressed to National Competent Authorities (NCAs) or financial institutions.

According to Article 16 of the EIOPA Regulation, EIOPA shall, where appropriate, conduct open public consultations and analyse the potential costs and benefits. In addition, EIOPA shall request the opinion of the Insurance and Reinsurance Stakeholder Group (IRSG) referred to in Article 37 of the EIOPA Regulation.

EIOPA has developed Guidelines on related undertakings, including participations. These Guidelines relate to Articles 92(1)(b) and 111(1)(m) of Directive 2009/138/EC<sup>1</sup> (Solvency II Directive), and to Articles 68, 168 and 171 of the Implementing Measures, without prejudice to Article 84 of the Implementing Measures<sup>2</sup>.

As a result of the above, on 2 June 2014 EIOPA launched a public consultation on the draft Guidelines on the treatment of related undertakings, including participations. The Consultation Paper is also published on EIOPA's website<sup>3</sup>.

These Guidelines are issued to NCAs to promote effective supervisory practices and consistent application of Union law with regard to:

- The identification of related undertakings and strategic participations;
- The determination of own funds in the case of participations in financial and credit institutions;
- The treatment of different types of related undertakings in the calculation of the Solvency Capital Requirement (hereinafter "SCR") in the standard formula and where an internal model is used.

## Content

This Final Report includes the feedback statement to the Consultation Paper (EIOPA-CP-14/036) and the Guidelines. The Impact Assessment and cost and benefit analysis, and the Resolution of comments are published separately on EIOPA's website.

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<sup>1</sup> OJ L 335, 17.12.2009, p. 1–155

<sup>2</sup> As published by the European Commission on 10 October 2014:

[http://ec.europa.eu/internal\\_market/insurance/docs/solvency/solvency2/delegated/141010-delegated-act-solvency-2\\_en.pdf](http://ec.europa.eu/internal_market/insurance/docs/solvency/solvency2/delegated/141010-delegated-act-solvency-2_en.pdf)

<sup>3</sup> <https://eiopa.europa.eu/consultations/consultation-papers/2014-closed-consultations/june-2014/public-consultation-on-the-set-1-of-the-solvency-ii-guidelines/index.html>

## **Next steps**

In accordance with Article 16 of the EIOPA Regulation, within 2 months of the issuance of these guidelines, each competent authority shall confirm if it complies or intends to comply with these guidelines. In the event that a competent authority does not comply or does not intend to comply, it shall inform EIOPA, stating the reasons for non-compliance.

EIOPA will publish the fact that a competent authority does not comply or does not intend to comply with these guidelines. The reasons for non-compliance may also be decided on a case-by-case basis to be published by EIOPA. The competent authority will receive advanced notice of such publication.

EIOPA will, in its annual report, inform the European Parliament, the Council and the European Commission of the guidelines issued, stating which competent authority has not complied with them, and outlining how EIOPA intends to ensure that concerned competent authorities follow its guidelines in the future.

## **2. Feedback statement**

### **Introduction**

EIOPA would like to thank the IRSG and all the participants to the public consultation for their comments on the draft Guidelines. The responses received have provided important guidance to EIOPA in preparing a final version of these Guidelines. All of the comments made were given careful consideration by EIOPA. A summary of the main comments received and EIOPA's response to them can be found in the sections below. The full list of all the comments provided and EIOPA's responses to them is published on EIOPA's website.

### **General comments**

This section highlights the main comments received during the public consultation and how EIOPA has responded to them, including how the proposal has been amended in the light of these comments.

#### **1. Treatment of horizontal groups**

- a) Some respondents to the public consultation, including the IRSG, stressed that the Guidelines did not reflect the economic nature of 'horizontal groups' which are formed on a contractual basis, rather than on the basis of capital ties. In particular, the concern appeared to be that in such group structures there may be 'related companies' which are contractually obliged to provide capital support to one another, but, when from an individual entity perspective, these arrangements create holdings that are less than 20%. One stakeholder proposed to address their concerns by seeking confirmation that where undertakings in mutual groups are linked to one another by contractual ties, these holdings should be considered as participations. It was also proposed that the identification of a related undertaking should be considered as the same both from the perspective of the participating undertaking as an individual entity and for group purposes. An important aspect of this concern seemed to be that if holdings within such group structures were not recognised as related undertakings, then in turn it would not be possible for them to qualify as strategic participations.
- b) Having reviewed these comments, EIOPA does not consider that changes to the Guidelines are necessary. The Guidelines concern the identification of related undertakings from the perspective of the individual undertaking or "solo" perspective, not group perspective, based on the framework set out in the Solvency II Directive and Implementing Measures. Where undertakings are linked based on contractual ties, this case may fall under the provision in Article 212(2) of the Solvency II Directive that a dominant or significant influence is exercised by one parent undertaking over another subsidiary undertaking, or Article 12 of Directive 83/349/EEC that the two undertakings are 'managed on a unified basis'. Guideline 1 recognises that a related undertaking may be

identified either based on capital ties or share ownership, or based on a broader range of elements such as membership rights in the case of mutuals, or representation from one undertaking on the administrative, management or supervisory body of another undertaking. Therefore, whilst it is not appropriate to state that where undertakings in mutual groups are linked to one another by contractual ties, these holdings are always considered to be participations as proposed by one stakeholder, a related undertaking may be identified according to Guideline 1.

In relation to the proposal that the identification of a related undertaking is the same both from the perspective of the participating undertaking as an individual entity and for group purposes, EIOPA would reaffirm that the Guidelines address the individual entity perspective. By way of explanation, it is stated in the introduction to the Guidelines that in most cases the identification will be the same from both the individual entity and group perspective. However, there are instances where this is not the case, and therefore EIOPA considers the proposed text in the introduction to be appropriate. With respect to the identification of strategic participations, it is necessary for undertakings to demonstrate how the requirements of Article 171 of the Implementing Measures are met. This issue is discussed further below in the sub-section: *Identification of strategic participations*.

## **2. Identification of related undertakings**

- a) From a different perspective, a number of stakeholders questioned the elements to be considered in order to determine whether one undertaking is able to exert a dominant or significant influence over another undertaking. A number of points were expressed, including that the occurrence of some of the events listed in the Guideline may lead to a certain influence, but should not lead to an assumption that a dominant or significant influence is exerted. It was also posited that the assessment of potential increases in shareholdings was difficult, due to the need to anticipate future developments. In view of this, it was proposed that the elements to be considered should be aligned with the accounting rules for setting up consolidated financial statements.
- b) As described in the Impact Assessment, EIOPA considered the need for there to be a convergent approach by supervisory authorities to the assessment of whether a dominant or significant influence is exercised. Without the specification provided, EIOPA considered that different approaches by different Member States are likely. EIOPA also decided that the assessment should follow the principles of Solvency II, rather than accounting rules.

Regarding the nature of the influence exercised, EIOPA would agree that the occurrence of one of the events listed in the Guideline should not result in an automatic assumption of significant or dominant influence being exercised. Nevertheless, each one signifies that an influence is exercised and therefore needs to be taken into account by the supervisory authority in the particular

case. In addition, as stated in the Guideline, supervisory authorities should consider any initial assessment by the participating undertaking, and therefore the undertaking can provide the supervisory authority with evidence as to why a significant or dominant influence is not exercised. Finally, EIOPA does not concur that the assessment of potential increases in shareholdings is inherently difficult, since the assessment is specifically linked to increases resulting from the holding of options, warrants or other similar instruments.

### **3. Identification of strategic participations**

- a) By far the highest number of comments was received on the issue of the identification of strategic participations. In general respondents considered that the Guideline on strategic participations was not necessary in addition to the provisions in Article 171 of the Implementing Measures, which some respondents considered to already be unduly burdensome. One particular concern was that the proposals for how undertakings should demonstrate that the value of the equity investment is likely to be materially less volatile were seen to imply a 'scientific type' analysis. It was also suggested that where several undertakings within the same group believe that they hold a strategic participation in the same related undertaking, only the ultimate participating undertaking – or, if different, the one setting the main policies for the group – should provide evidence regarding its strategy to hold the participation.
- b) The Guideline proposed during the public consultation intended to ensure that undertakings provided a sufficiently robust demonstration of how they had satisfied the conditions in Article 171 of the Implementing Measures, in view of the substantially different treatment for strategic participations. As explained in the Impact Assessment, they were also intended to promote consistent application given the possibility for different interpretations of the relatively general terms used in the Implementing Measures.

Based on the comments received, EIOPA has reviewed the Guideline and judged that some of the proposed elements were too prescriptive or more appropriate for the explanatory text than for the Guideline, in particular relating to the valuation of the equity investment. Consequently, a number of changes have been made to the Guideline to reflect the fact that the elements proposed were either more explanatory as to how these requirements can be met, or based on the comments from stakeholders, not practical to implement in all cases.

In relation to the evidence required on the undertaking's strategy to hold the participation, EIOPA has clarified that such evidence needs to be provided for each undertaking which holds the participation. However, it is recognised that where there are multiple holdings in the same group, the strategy of each of the undertakings of the group will need to be consistent with the overall group strategy. Therefore, although it will depend on the particular circumstances, references to the group strategy are likely to be appropriate.

#### **4. Information on indirect holdings**

- a) It was argued that part of the Guidelines was not realisable because information on indirect participations is not available for entities that do not prepare group closing accounts. The assertion made was that if participations are held indirectly via other undertakings, the deduction is made at the level of the latter undertaking.
- b) EIOPA does not agree with this approach, which it believes is not consistent with Article 212(2) of the Solvency II Directive where it is stated that participations held directly or indirectly are within scope. Under Solvency II, undertaking will need to know the value of their participations, whether they are held directly or indirectly, and whether or not they currently have the IT systems to acquire this information.

#### **5. Deductions in respect of participations in financial and credit institutions**

- a) Comments were received on the approach to be taken where own-fund items relating to participations in financial and credit institutions need to be deducted in accordance with Article 68 of the Implementing Measures, but the items to be deducted are not classified into the tiers set out in paragraph 5 of this Article. EIOPA proposed that where the items are not classified into such tiers, the deduction should be made from the items included in Article 69(a)(i),(ii),(iv) and (vi) of the Implementing Measures (i.e. “unrestricted Tier 1 items”<sup>4</sup>). In response to this, stakeholders agreed that investments in the ordinary shares of a participation should be deducted from “unrestricted Tier 1” own funds, but they contested the treatment of investments in subordinated liabilities, which they believed should be deducted from Tier 2 own funds.
- b) EIOPA would reassert the position that it took for the public consultation and therefore has not changed the Guidelines. Where the tier is not known, a classification by the supervisory authority is not required by Article 68 of the Implementing Measures and is not considered to be practical. In view of this, an assumption needs to be made as to which is the appropriate Tier for the deduction, which should not be based simply on the form in which the item is presented or described. As a result, even though subordinated liabilities in their highest “quality” form will constitute “restricted Tier 1 items”<sup>5</sup> and not “unrestricted Tier 1 items”, given that the tier is unknown a prudent approach should be taken. In addition, holdings in the related undertaking would usually contribute to the excess of assets over liabilities which would represent Tier 1 items within the reconciliation reserve.

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<sup>4</sup> The term “unrestricted” in this context means Tier 1 items which are not subject to any limits as to the amount of the undertaking’s Tier 1 own funds that these items can represent. These limits are described in Article 82 of the Implementing Measures.

<sup>5</sup> The term “restricted” in this context means Tier 1 items which are subject to the 20% limit as to the amount of the undertaking’s Tier 1 own funds that these items can represent. This limit is described in Article 82 of the Implementing Measures.

## **General nature of the participants to the Public Consultation**

EIOPA received comments from the IRSG and eight responses from other stakeholders to the public consultation. All non-confidential comments received have been published on EIOPA's website.

Respondents can be classified into three main categories: European trade, insurance, or actuarial associations; national insurance or actuarial associations; and (re)insurance groups or undertakings.

## **IRSG opinion**

The IRSG opinion on the draft set 1 of the Solvency II Guidelines on Pillar 1 and Internal Models, as well as the particular comments on the Guidelines at hand, can be consulted on EIOPA's website<sup>6</sup>.

## **Comments on the Impact Assessment**

A separate Consultation Paper was prepared covering the Impact Assessment for the Set 1 of EIOPA Solvency II Guidelines. Where the need for reviewing the Impact Assessment has arisen following comments on the guidelines, the Impact Assessment Report has been revised accordingly. The revised Impact Assessment on the Set 1 of EIOPA Solvency II Guidelines can be consulted on EIOPA's website.

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<sup>6</sup> <https://eiopa.europa.eu/about-eiopa/organisation/stakeholder-groups/sgs-opinion-feedback/index.html>

## **Annex: Guidelines**

### **1. Guidelines on treatment of related undertakings, including participations**

#### **Introduction**

- 1.1. According to Article 16 of Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (hereinafter "EIOPA Regulation")<sup>7</sup> EIOPA is drafting Guidelines on the treatment of related undertakings, including participations.
- 1.2. The Guidelines relate to Articles 92(1)(b) and 111(1)(m) of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (hereinafter "Solvency II")<sup>8</sup> as well as to Articles 68, 168 and 171, without prejudice to Article 84 of the Implementing Measures.
- 1.3. These Guidelines are addressed to supervisory authorities under Solvency II.
- 1.4. The purpose of these Guidelines is to provide guidance on the identification and the treatment of related undertakings and participations to ensure a consistent approach across Member States.
- 1.5. For the purpose of these Guidelines the participating undertaking is the undertaking which is calculating its solvency position. The term related undertaking refers to any related undertaking of that participating undertaking. The term participation is used to denote one type of related undertaking. Appendix A of the Final Report provides an overview of the different terms used in Solvency II when speaking about the relationship between two or more undertakings.
- 1.6. These Guidelines cover the treatment of all related undertakings in the calculation of the Solvency Capital Requirement (hereinafter "SCR") and include guidance on the determination of own funds in the case of participations in financial and credit institutions. The meaning of financial and credit institutions is explained in Appendix B of the Final Report.
- 1.7. The Guidelines follow a holistic approach. They describe first the identification of different types of related undertakings, including participations. They then cover the treatment of the different types of related undertakings, specifically participations in financial and credit institutions and strategic participations. Finally, they include guidance on the treatment of related undertakings in the standard formula and in internal models to calculate the SCR.
- 1.8. Where these Guidelines refer to the valuation or value of a related undertaking, reference should be made to Article 13 of the Implementing Measures.

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<sup>7</sup> OJ L 331, 15.12.2010, p. 48–83

<sup>8</sup> OJ L 335, 17.12.2009, p. 1-155

- 1.9. The Guidelines concern the treatment of related undertakings including participations on an individual entity basis. In most cases the identification of a related undertaking will be the same both from the perspective of the participating undertaking as an individual entity and for group purposes. However, in certain situations there will be differences: the business of the related undertaking may be such that the participating undertaking and related undertaking are not subject to group supervision according to Article 213 of Solvency II. In addition, there may be the case where a number of entities within a group hold voting rights or capital in an undertaking that when combined together, amount to 20% or more of the undertaking's voting rights or capital. Consequently, such an undertaking would be identified as a related undertaking at group level. However, if the holding of each individual entity within the group is lower than 20%, the undertaking would not be identified as a related undertaking by any of those entities within the group at individual entity level.
- 1.10. In certain circumstances the individual entity provisions for related undertakings are used to calculate the contribution of those undertakings to the group SCR. These circumstances are set out in the Implementing Measures and EIOPA's Guidelines on Group solvency calculation.
- 1.11. Appendix C of the Final Report provides, in the form of a decision tree, a methodology for the treatment of all types of related undertakings. Additional analysis and calculations will be necessary for financial and credit participations held indirectly as set out in Guideline 4 and Guideline 7. In some cases, the treatment of holdings is identical to the treatment that would result from applying the standard formula where no participation exists.
- 1.12. If not defined in these Guidelines the terms have the meaning defined in the legal acts referred to in the introduction.
- 1.13. The Guidelines shall apply from 1 April 2015.

### **Guideline 1 - Identification**

- 1.14. Participating undertakings should identify their related undertakings and participations based on an assessment from their perspective as an individual entity.
- 1.15. When identifying a related undertaking based on share ownership, directly or by way of control, participating undertakings should determine:
- (a) their holding of voting rights as a percentage of an undertaking's voting rights;
  - (b) their holding of all classes of share capital issued by an undertaking as a percentage of that undertaking's issued share capital, regardless of voting rights.

Where (a) or (b) are 20% or higher, participating undertakings should treat their investment in the undertaking as a participation.

Where the participation is in an insurance or reinsurance undertaking subject to Solvency II, the assessments under (a) will generally relate to paid-in ordinary share capital referred to in Article 69(a)(i) of the Implementing Measures, and under (b) to paid-in ordinary share capital and paid-in preference shares referred to in Article 69(a)(v) of the Implementing Measures.

- 1.16. Participating undertakings should ensure that they are able to identify the effect of changes in the share capital of related undertakings on the assessment described in the preceding paragraph each time the participating undertaking calculates its SCR in accordance with Article 102 of Solvency II.
- 1.17. When identifying a related undertaking pursuant to Article 212(2) of Solvency II on the basis that the participating undertaking can exert a dominant or significant influence over another undertaking, supervisory authorities should consider:
  - (a) current shareholdings of the participating undertaking in the undertaking and potential increases due to the holding of options, warrants or similar instruments;
  - (b) membership rights of the participating undertaking in a mutual or mutual-type undertaking and potential increases in such rights;
  - (c) representation from the participating undertaking on the administrative, management or supervisory body of the undertaking;
  - (d) involvement of the participating undertaking in policy-making processes of the undertaking, including decision-making about dividends or other distributions;
  - (e) material transactions between the participating undertaking and the undertaking;
  - (f) interchange of persons effectively running the participating undertaking and the undertaking;
  - (g) provision of essential technical information to the undertaking;
  - (h) management of the participating undertaking and undertaking on a unified basis.

Supervisory authorities should consider any initial assessment by the participating undertaking in accordance with points (a) to (h) of this paragraph.

## **Guideline 2 - Identification of participations in financial and credit institutions**

- 1.18. Participating undertakings should treat a related undertaking as a financial or credit institution, where it is an institution listed or described in accordance with Article 4(1) and (5) of Directive 2013/36/EU or with Article 4(1) of Directive 2004/39/EC. These descriptions cover any institution which performs the functions or carries out the business described pursuant to those Articles, notwithstanding that the institution may not be subject to those Directives.

- 1.19. Participating undertakings should ensure that any participation in a financial or credit institution where voting rights or capital are held indirectly is treated in the same way as a participation in a financial or credit institution where voting rights or capital are held directly.

### **Guideline 3 - Identification of a strategic participation**

- 1.20. Participating undertakings should identify strategic participations in accordance with Article 171 of the Implementing Measures as follows:
- (a) participating undertakings using the standard formula to calculate their SCR should identify strategic participations regardless of whether their participation is in an insurance or reinsurance undertaking, in a financial or credit institution or in any other related undertaking;
  - (b) participating undertakings using an internal model to calculate their SCR need to identify strategic participations in financial and credit institutions only for the purpose of assessing whether Article 68(3) of the Implementing Measures applies.
- 1.21. For the purpose of demonstrating their compliance with the requirements of Article 171 of the Implementing Measures, participating undertakings should not divide a participation into different parts, treating some parts as strategic and others not. Where a particular participation has been identified as strategic:
- (a) in the case of a participation in a financial or credit institution, all investments in its own funds are strategic;
  - (b) in the case of any other related undertaking, all equity investments in the participation are strategic.
- 1.22. In demonstrating that the value of the equity investment is likely to be materially less volatile, in accordance with Article 171(a) of the Implementing Measures, participating undertakings should ensure that:
- (a) consistent and appropriate valuations are applied over time both to the participation and to the other equities selected as a basis of comparison;
  - (b) they consider the impact of their influence on the participation's value.
- 1.23. In demonstrating that the nature of the investment is strategic, in accordance with Article 171(b)(i) to (iii) of the Implementing Measures, participating undertakings should:
- (a) indicate the period for which the strategy of holding the participation is intended to apply;
  - (b) consider the impact of market conditions on the main policies;
  - (c) identify any significant factors affecting, or constraints on, the participating undertaking's ability to maintain its strategy and how these could or would be mitigated.

- 1.24. In demonstrating the existence of a durable link, in accordance with Article 171(b)(iv) of the Implementing Measures, participating undertakings should consider the following criteria:
- (a) whether a stable relationship between the two undertakings exists over time;
  - (b) whether that stable relationship results in a close economic bond, the sharing of risks and benefits between the undertakings or exposure to risks from one to the other;
  - (c) the form of the relationship between the two undertakings, which may include ownership, joint products or distribution lines, cross-selling, the creation of joint ventures or other long term operational or financial links.
- 1.25. In accordance with Article 171(b)(v) of the Implementing Measures, a participating undertaking that is part of a group should regard the main policies guiding or limiting the actions of the group as those defined by the ultimate parent undertaking or, if different, by the undertaking which sets the main policies for the group as a whole.
- 1.26. Participating undertakings should document their consideration of the matters set out in Article 171 of the Implementing Measures and paragraphs 1.21 to 1.25, including any other relevant factors, together with relevant supporting material.

#### **Guideline 4 - Scope of calculations for Article 68 of the Implementing Measures**

- 1.27. When determining the value of participations in financial and credit institutions for the purposes of Article 68 of the Implementing Measures, participating undertakings should include holdings of equity and any other own-fund items, whether held directly or indirectly.
- 1.28. Participating undertakings should apply the following approaches:
- (a) for direct holdings, the value of participations in financial and credit institutions, as determined by the participating undertaking in accordance with Solvency II valuation principles, should be used for the purposes of Article 68 of the Implementing Measures as set out in Guideline 5;
  - (b) participations in financial and credit institutions, held indirectly via another participation in a financial or credit institution should not be considered under Article 68 of the Implementing Measures, as their value should already have been included in the value of the directly-held participation in a financial or credit institution in accordance with point (a);
  - (c) a deduction for a participation in a financial or credit institution held indirectly should only arise where related undertakings between the

participating undertaking and the financial or credit participation are other than financial and credit participations;

- (d) for other indirect holdings in a financial or credit institution the value of the participation as determined by the related undertaking in accordance with Article 13 of the Implementing Measures should be used for the purposes of Article 68 of the Implementing Measures;
- (e) the values used for the purposes of Article 68 of the Implementing Measures should represent the participating undertaking's proportional ownership, held directly and indirectly, of the participation in the financial or credit institution.

### **Guideline 5 - Calculations for the purpose of Article 68 of the Implementing Measures**

- 1.29. In calculating 10% of the items included in Article 69(a)(i), (ii), (iv) and (vi) of the Implementing Measures for the purposes of Article 68 of the Implementing Measures, participating undertakings should use the amount of basic own-fund items before any deduction pursuant to Article 68 of the Implementing Measures in respect of participations in financial and credit institutions.
- 1.30. Where the value of all participations in financial and credit institutions, other than participations referred to in Article 68(1) of the Implementing Measures, does not exceed 10% of items included in Article 69(a)(i), (ii), (iv) and (vi) of the Implementing Measures for the purposes of Article 68(2) of the Implementing Measures, then no deduction takes place and Guideline 8 or 9 apply.
- 1.31. Participating undertakings should only apply Article 68(3) of the Implementing Measures in the cases where:
  - (a) they have demonstrated in accordance with Guideline 3 that the participation meets the criteria for a strategic participation;
  - (b) the participating undertaking and the participation are included in calculations on the basis of method 1 in accordance with Directive 2002/87/EC for the financial conglomerate to which they belong or on the basis of method 1 under Solvency II.

### **Guideline 6 - Deductions in respect of participations in financial and credit institutions**

- 1.32. Where deductions in accordance with Article 68(1) and (2) of the Implementing Measures cannot be made from the corresponding tier as set out in Article 68(5) of the Implementing Measures, undertakings should adopt the following approaches:
  - (a) where the items to be deducted are not classified into the tiers set out in Article 68(5) of the Implementing Measures, all deductions should be

made from the amount of items included in Article 69(a)(i), (ii), (iv) and (vi) of the Implementing Measures;

- (b) where the amount of the deduction exceeds the amount from which it is required to be deducted in accordance with Article 68(5) of the Implementing Measures, the excess should be deducted as follows:
  - (i) holdings of Additional Tier 1 instruments in excess of items included in Article 69(a)(iii), (v) and (b) of the Implementing Measures are deducted from items included in Article 69(a)(i), (ii), (iv) and (vi) of the Implementing Measures;
  - (ii) holdings of Tier 2 instruments in excess of basic own funds included in Article 72 of the Implementing Measures are deducted first from items included in Article 69(a)(iii), (v) and (b) of the Implementing Measures, and then from items included in Article 69(a)(i), (ii), (iv) and (vi) of the Implementing Measures until the deduction is made in full.

#### **Guideline 7 - Adjustments due to deductions of indirectly-held participations in financial and credit institutions**

- 1.33. Where a deduction of the value of a participation in a financial or credit institution held indirectly is required, in full or in part, in accordance with Article 68 of the Implementing Measures, participating undertakings should, only for the purposes of calculating the SCR:
- (a) reduce, by the amount of that deduction, the value of the directly-held related undertaking, which is an asset of the participating undertaking, through which the participation in the financial or credit institution is held indirectly;
  - (b) for the adjustment described in point (a), follow the approach set out in Article 68(5) of the Implementing Measures and in Guideline 6.

#### **Guideline 8 - Application of the standard formula to related undertakings**

- 1.34. This Guideline applies to participating undertakings using the standard formula to calculate the SCR in respect of the risks arising from related undertakings held directly by the participating undertaking.
- 1.35. Where a participating undertaking holds as assets own-fund items of a related undertaking and their value is not deducted in full, or at all, from the participating undertaking's own funds as a result of applying Article 68 of the Implementing Measures, risk charges for the remaining value of those holdings should be calculated in accordance with the standard formula.
- 1.36. The participating undertaking should apply the standard formula as follows:
- (a) holdings in ordinary or preference share capital of the related undertaking should be treated as equities applying the equity risk sub-module as appropriate;

- (b) holdings in subordinated liabilities issued by the related undertaking should be treated as financial instruments taking account of contractual terms and applying market stresses as appropriate, including the interest rate, spread, currency, concentration and other risk sub-modules as appropriate;
- (c) any holdings of the above which exhibit both equity and bond features should be dealt with in accordance with Guideline 5 of the Guidelines on the Treatment of market and counterparty risk exposures in the standard formula.

### **Guideline 9 - Application of internal models to related undertakings**

- 1.37. This Guideline applies to participating undertakings using a full or partial internal model to calculate the SCR in respect of the risks arising from related undertakings.
- 1.38. Where a participating undertaking holds as assets own-fund items of a related undertaking and their value is not deducted in full, or at all, from the participating undertaking's own funds as a result of applying Article 68 of the Implementing Measures, the risks arising from the remaining value of those holdings should be captured as part of the internal model.
- 1.39. The participating undertaking should cover in the internal model all material quantifiable risks arising from its related undertakings, taking account of exposures to the related undertakings including holdings of equity and subordinated liabilities. Relevant measures of these risks should be reflected in the model.
- 1.40. Where a participating undertaking performs the SCR calculation at individual entity level for a participation or related undertaking in a manner which takes account of risks to the value of the underlying assets and liabilities of that related undertaking, it should ensure this is an appropriate calculation at individual entity level, and should not replace that calculation by a consolidated calculation as though the participating undertaking and its related undertaking were a Solvency II group.

### **Compliance and Reporting Rules**

- 1.41. This document contains Guidelines issued under Article 16 of the EIOPA Regulation. In accordance with Article 16(3) of the EIOPA Regulation, Competent Authorities and financial institutions shall make every effort to comply with guidelines and recommendations.
- 1.42. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.
- 1.43. Competent authorities shall confirm to EIOPA whether they comply or intend to comply with these Guidelines, with reasons for non-compliance, within two months after the issuance of the translated versions.

1.44. In the absence of a response by this deadline, competent authorities will be considered as non-compliant to the reporting and reported as such.

**Final Provision on Reviews**

1.45. The present Guidelines shall be subject to a review by EIOPA.

## 2. Explanatory text

### **Guideline 2 - Identification of participations in financial and credit institutions**

Participating undertakings should treat a related undertaking as a financial or credit institution, where it is an institution listed or described in accordance with Article 4(1) and (5) of Directive 2013/36/EU or with Article 4(1) of Directive 2004/39/EC. These descriptions cover any institution which performs the functions or carries out the business described pursuant to those Articles, notwithstanding that the institution may not be subject to those Directives.

Participating undertakings should ensure that any participation in a financial or credit institution where voting rights or capital are held indirectly is treated in the same way as a participation in a financial or credit institution where voting rights or capital are held directly.

- 2.1. The institution may not be subject to Directive 2006/48/EC or Directive 2004/39/EC, because it is a third country undertaking and thus out of scope of those Directives.
- 2.2. The following examples are intended to illustrate the identification of participations in financial and credit institutions for the purposes of Article 68 of the Implementing Measures:

#### Example 1:

Participating undertaking A holds 100% of the shares in a bank B in Bermuda.

- Bank B meets the definition of a credit institution based on its activity, regardless of its location and whether it is subject to Directive 2013/36/EU.
- Bank B is a financial or credit participation of participating undertaking A.

#### Example 2:

Participating undertaking A holds 75% of the shares in an asset manager C.

- C is a financial institution.
- C is a financial or credit participation of participating undertaking A.

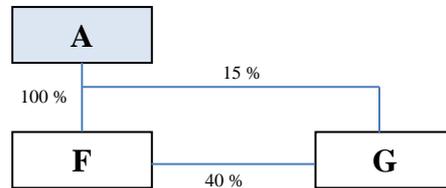
#### Example 3:

Participating undertaking A holds 60% of the shares in an insurer D. Insurer D holds 80% of the shares in a bank E.

- E is a credit institution.
- E is a financial or credit participation of D.
- A controls D; D controls E.
- E is a financial or credit participation of A.

#### Example 4:

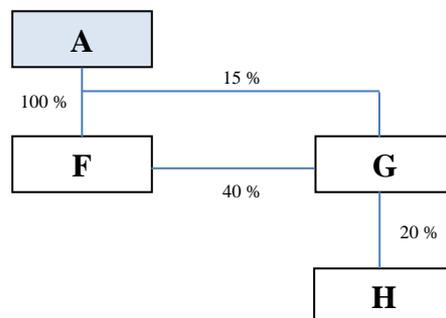
Participating undertaking A holds 100% of the shares in a bank F. Bank F holds 40% of the shares in a financial institution G. Participating undertaking A also holds 15% of the shares in financial institution G.



- F is a financial or credit participation of A.
- G is a financial or credit participation of F.
- G is a financial or credit participation of A, because A controls F as well as holding 15% of the shares in G directly. Therefore A controls G (40% indirectly through F and 15% directly).

#### Example 5:

Following from Example 4, participating undertaking A holds 100% of the shares in a bank F. Bank F holds 40% of the shares in a financial institution G. Participating undertaking A also holds 15% of the shares in financial institution G. G holds 20% of the shares in a bank H.



- H is a financial or credit participation of G.
- A controls G, because A controls 55% of G via its indirect and direct holdings in G.
- A's holdings in H can be calculated as:  $(40\% + 15\%) \times 20\%$ , which is less than 20%.
- A believes that it can exert significant influence on H, and therefore H is a financial or credit participation of A.

#### Example 6:

Participating undertaking A holds 100% of the shares in a service company I. Service company I has a subsidiary J. Subsidiary J carries out financial leasing business.

- J is a financial institution.
- J is a financial or credit participation of A.

### Example 7:

Participating undertaking A holds 100% of the shares in undertaking L. L's only activity is the holding of investment in its subsidiaries M and N. M and N are insurers.

- L is an insurance holding company, because it holds at least one insurance subsidiary.
- L is not a financial institution.
- L is not a financial or credit participation of A.

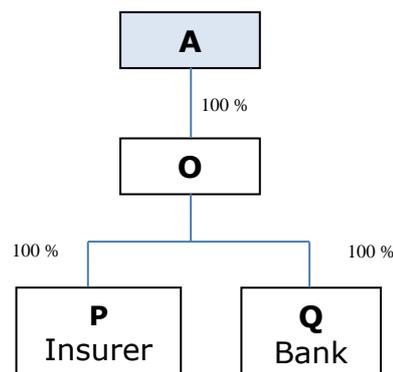
### Example 8:

Participating undertaking A holds 100% of the shares in undertaking K. K has no related undertakings, but holds small percentages in a range of investments. K's investments include banks, industrials and insurance companies.

- K is a financial institution, because its main purpose is to acquire holdings.
- K is a financial or credit participation of A.

### Example 9:

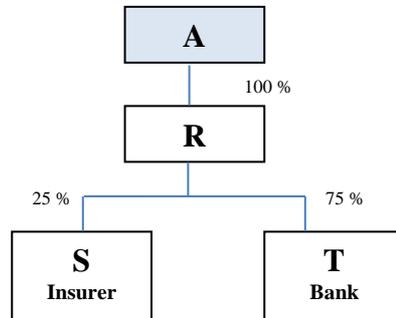
Participating undertaking A holds 100% of the shares in undertaking O. O's only activity is the holding of investments in its subsidiaries P and Q. P is an insurer. Q is a bank.



- Q is a financial or credit participation of A.
- An assessment of O would need to be done to determine whether it is an insurance holding company or a mixed-activity insurance holding company.
- If O is either of these two, it is not a financial institution.
- If O is not an insurance holding company or a mixed-activity insurance holding company, an assessment would need to be done to determine whether O is a mixed financial holding company.
- If O is a mixed financial holding company, it is a financial institution. In this case, O would be a financial or credit participation of A.

### Example 10:

Participating undertaking A holds 100% of the shares in undertaking R. R's only activity is the holding of investments in insurer S and bank T. R holds 25% of S and 75% of T.



- T is a financial or credit participation of A.
- R is not an insurance holding company or a mixed-activity insurance holding company because it does not have at least one insurance subsidiary.
- An assessment of R would need to be done to determine whether it is a financial holding company or mixed financial holding company
- If R is a financial holding company or mixed financial holding company it is a financial institution. In this case R would be a financial or credit participation of A.

### Guideline 3 - Identification of a strategic participation

Participating undertakings should identify strategic participations in accordance with Article 171 of the Implementing Measures as follows:

- (a) participating undertakings using the standard formula to calculate their SCR should identify strategic participations regardless of whether their participation is in an insurance or reinsurance undertaking, in a financial or credit institution or in any other related undertaking;
- (b) participating undertakings using an internal model to calculate their SCR need to identify strategic participations in financial and credit institutions only for the purpose of assessing whether Article 68(3) of the Implementing Measures applies.

For the purpose of demonstrating their compliance with the requirements of Article 171 of the Implementing Measures, participating undertakings should not divide a participation into different parts, treating some parts as strategic and others not. Where a particular participation has been identified as strategic:

- (a) in the case of a participation in a financial or credit institution, all investments in its own funds are strategic;
- (b) in the case of any other related undertaking, all equity investments in the participation are strategic.

In demonstrating that the value of the equity investment is likely to be materially less volatile, in accordance with Article 171(a) of the Implementing Measures, participating undertakings should ensure that:

- (a) consistent and appropriate valuations are applied over time both to the participation and to the other equities selected as a basis of comparison;
- (b) they consider the impact of their influence on the participation's value.

In demonstrating that the nature of the investment is strategic, in accordance with Article 171(b)(i) to (iii) of the Implementing Measures, participating undertakings should:

- (a) indicate the period for which the strategy of holding the participation is intended to apply;
- (b) consider the impact of market conditions on the main policies;
- (c) identify any significant factors affecting, or constraints on, the participating undertaking's ability to maintain its strategy and how these could or would be mitigated.

In demonstrating the existence of a durable link, in accordance with Article 171(b)(iv) of the Implementing Measures, participating undertakings should consider the following criteria:

- (a) whether a stable relationship between the two undertakings exists over time;
- (b) whether that stable relationship results in a close economic bond, the sharing of risks and benefits between the undertakings or exposure to risks from one to the other;
- (c) the form of the relationship between the two undertakings, which may include ownership, joint products or distribution lines, cross-selling, the creation of joint ventures or other long term operational or financial links.

In accordance with Article 171(b)(v) of the Implementing Measures, a participating undertaking that is part of a group should regard the main policies guiding or limiting the actions of the group as those defined by the ultimate parent undertaking or, if different, the undertaking which sets the main policies for the group as a whole.

Participating undertakings should document their consideration of the matters set out in Article 171 of the Implementing Measures and paragraphs 1.21 to 1.25, including any other relevant factors, together with relevant supporting material.

2.3. The documentation of the strategy would consist of the participating undertaking's internal documentation, which needs to be consistent with externally communicated or relevant publically available information.

- 2.4. In demonstrating that the value of the equity investment is likely to be materially less volatile in respect of paragraph 1.22(a) of the Guideline, the participating undertaking may consider share indices and other benchmarking tools to help support their assessment. Under Solvency II valuation principles, different approaches may be required depending upon the type of the investment.
- 2.5. In demonstrating that the value of the equity investment is likely to be materially less volatile, undertakings would need to differentiate between when a related undertaking is valued using the adjusted equity method (i.e. value equals the excess of assets over liabilities) and when it is valued using the default valuation method of the quoted market price (i.e. value equals the quoted market price of the participation's shares). This does not interfere with valuation principles.
- 2.6. In demonstrating that the nature of the investment is strategic, the explanation referred to in paragraph 1.23(b) of the Guideline may be drawn from different sources including business plans, existing business models, contingency plans, management actions, including those identified for the purposes of Solvency II, and other relevant material.
- 2.7. In order to demonstrate that there is a durable link, a holistic assessment is needed. In cases where investment assets, for which the equity charge applies, are put into the participation solely to benefit from treatment as a strategic participation, a durable link may not be assumed.
- 2.8. In demonstrating that its strategy to continue holding the participation for a long period is consistent with the main policies guiding or limiting the actions of the group, the evidence may be drawn from different sources including business plans, existing business models, contingency plans, management actions, including those identified for the purposes of Solvency II, and other relevant material.
- 2.9. Referring to management actions where the participating undertaking is part of a group, its strategy to continue holding a participation for a long period may not be consistent with contingency plans or actions proposed by the group in respect of Solvency II, if the group has identified the sale or closure of that participation as a contingent action, or the potential sale of the participation has been used as a means of demonstrating availability of group own funds in accordance with Article 330(1)(c) of the Implementing Measures. The facts would need to be assessed on a case by case basis as to the level of consistency or inconsistency.
- 2.10. Referring to management actions where the participating undertaking is a member of more than one group, the ultimate parent undertaking that exerts the most influence over the participating undertaking is the undertaking that can revise the policies of the participating undertaking and particularly its strategy to continue holding a participation for a long period.

2.11. Investment funds or other investment vehicles that qualify as related undertakings are not classified as a strategic participation and eligible for the strategic risk charge just because an undertaking owns a large share in it.

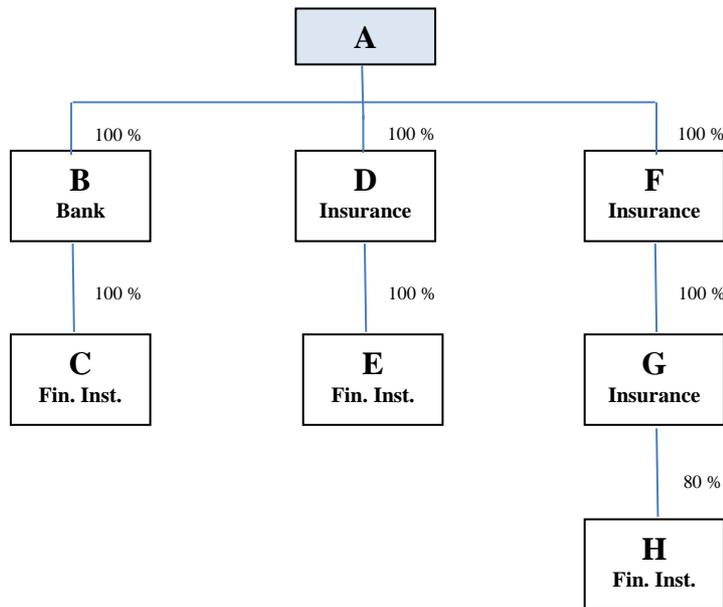
#### **Guideline 4 - Scope of calculations for Article 68 of the Implementing Measures**

When determining the value of participations in financial and credit institutions for the purposes of Article 68 of the Implementing Measures, participating undertakings should include holdings of equity and any other own-fund items, whether held directly or indirectly.

Participating undertakings should apply the following approaches:

- (a) for direct holdings, the value of participations in financial and credit institutions, as determined by the participating undertaking in accordance with Solvency II valuation principles, should be used for the purposes of Article 68 of the draft Implementing Measures as set out in Guideline 5;
- (b) participations in financial and credit institutions, held indirectly via another participation in a financial or credit institution should not be considered under Article 68 of the Implementing Measures, as their value should already have been included in the value of the directly-held participation in a financial or credit institution in accordance with point (a);
- (c) a deduction for a participation in a financial or credit institution held indirectly should only arise where related undertakings between the participating undertaking and the financial or credit participation are other than financial and credit participations;
- (d) for other indirect holdings in a financial or credit institution the value of the participation as determined by the related undertaking in accordance with Article 13 of the Implementing Measures should be used for the purposes of Article 68 of the Implementing Measures;
- (e) the values used for the purposes of Article 68 of the Implementing Measures should represent the participating undertaking's proportional ownership, held directly and indirectly, of the participation in the financial or credit institution.

Example: Participating insurance undertaking A has a number of related undertakings as depicted below, for simplicity it is assumed that all holdings are of ordinary shares:



The values of holdings are as follows:

Name of Participating undertaking	Name of related undertaking	Value of the related undertaking on a Solvency II basis
A	B	500
	D	5000
	F	6000
B	C	300
D	E	700
F	G	3000
G	H (G's proportional share)	80% x 2500 = 2000

From the perspective of A:

B, C, E and H are financial and credit participations. The following values are within the scope of Article 68 of the Implementing Measures:

- B, 500
- E, 700
- H, 2000

The value of C is not an input to Article 68 of the Implementing Measures, because it is included in the value of B.

### **Guideline 5 - Calculations for the purpose of Article 68 of the draft Implementing Measures**

In calculating 10% of the items included in Article 69(a)(i), (ii), (iv) and (vi) of the Implementing Measures for the purposes of Article 68 of the Implementing Measures, participating undertakings should use the amount of basic own-fund items before any deduction pursuant to Article 68 of the Implementing Measures in respect of participations in financial and credit institutions.

Where the value of all participations in financial and credit institutions, other than participations referred to in Article 68(1) of the Implementing Measures, does not exceed 10% of items included in Article 69(a)(i), (ii), (iv) and (vi) of the Implementing Measures for the purposes of Article 68(2) of the Implementing Measures, then no deduction takes place and Guideline 8 or 9 apply.

Participating undertakings should only apply Article 68(3) of the Implementing Measures in the cases where:

- (a) they have demonstrated in accordance with Guideline 3 that the participation meets the criteria for a strategic participation;
- (b) the participating undertaking and the participation are included in calculations on the basis of method 1 in accordance with Directive 2002/87/EC for the financial conglomerate to which they belong or on the basis of method 1 under Solvency II.

2.12. The following examples are intended to illustrate the application of the deduction approach required by Article 68 of the Implementing Measures and are not intended to reflect the application of Solvency II limits or of the minimum capital ratios for financial and credit institutions.

2.13. Article 68 of the Implementing Measures envisages deductions in two cases:

- (a) Participations with a value exceeding the 10% threshold on an individual entity basis – Article 68(1) of the Implementing Measures.
- (b) Participations where the individual value does not exceed the threshold but the aggregate of all such participations does – Article 68(2) of the Implementing Measures.

#### Case 1 – Article 68(1) of the Implementing Measures

Insurance undertaking A owns a participation in financial or credit institution B. The value of A's holdings in B is 47.

A's own funds position is as follows:

Tier 1 (Article 69(a)(i), (ii), (iv) and (vi) items):	400
Tier 1 (Article 69(a)(iii), (v) and (b) items):	40
Tier 2:	50

Base figure for threshold = 400

Threshold = 10% x 400 = 40

Value of B = 47 which is > 40

This means that the value of B must be deducted in full.

### Case 2 – Article 68(2) of the Implementing Measures

Insurance undertaking A holds participations in two financial and credit institutions E and F. A's holding in E is valued at 25 and in F at 32 giving a total of 57.

Base figure for threshold = 400

Threshold = 10% x 400 = 40

Value of E = 25 which is < 40

Value of F = 32 which is < 40

No deduction of E or F under Article 68(1) of the Implementing Measures.

Value of E + F = 57 which is > 40

Excess over threshold = 57-40 = 17

Deduction of 17 required under Article 68(2) of the Implementing Measures.

How is this deduction apportioned over the holdings in E and F?

A's holdings comprise:	E	F
Common Equity Tier 1	20	23
Additional Tier 1	5	7
Tier 2		2
Total	25	32

Before proceeding with the deduction, undertaking A needs to apply a pro-rata basis ( $17/57 = 0.2982$ ) to each of the items of E and F:

Participation	Common equity Tier 1	Additional Tier 1	Tier 2	Total
E	20	5		25
Pro-rated deduction at 17/57	5.96	1.49		7.45
F	23	7	2	32
Pro-rated deduction at 17/57	6.86	2.09	0.60	9.55
Total deduction				17

### **Guideline 6 - Deductions in respect of participations in financial and credit institutions**

Where deductions in accordance with Article 68(1) and (2) of the Implementing Measures cannot be made from the corresponding tier as set out in Article 68(5) of the Implementing Measures, undertakings should adopt the following approaches:

- (a) where the items to be deducted are not classified into the tiers set out in Article 68(5) of the Implementing Measures, all deductions should be made from the amount of items included in Article 69(a)(i), (ii), (iv) and (vi) of the Implementing Measures;
- (b) where the amount of the deduction exceeds the amount from which it is required to be deducted in accordance with Article 68(5) of the Implementing Measures, the excess should be deducted as follows:
  - (i) holdings of Additional Tier 1 instruments in excess of items included in Article 69(a)(iii), (v) and (b) of the Implementing Measures are deducted from items included in Article 69(a)(i), (ii), (iv) and (vi) of the draft Implementing Measures;
  - (ii) holdings of Tier 2 instruments in excess of basic own funds included in Article 72 of the draft Implementing Measures are deducted first from items included in Article 69(a)(iii), (v) and (b) of the Implementing Measures, and then from items included in Article 69(a)(i), (ii), (iv) and (vi) of the Implementing Measures until the deduction is made in full.

2.14. Deductions are made on the basis of the Solvency II valuation of investments in financial and credit institutions, and are not based on other sectoral rules. However, the sectoral classification of each investment needs to be identified for the corresponding deduction approach. For example, if participating undertaking A owns a subordinated liability instrument issued by Bank B which is a participation, any deduction is based on A's valuation of the instrument on a Solvency II basis. A needs to know whether the instrument is additional Tier

1 or Tier 2 according to the banking sector to determine the tier from which it will be deducted under Article 68(5) of the Implementing Measures.

2.15. The following examples illustrate the corresponding deduction approach:

Returning to the example in Case 1 above; insurance undertaking A owns a participation in financial or credit institution B which is required to be deducted in full. A's holdings in B comprise:

Common Equity Tier 1: 40  
 Additional Tier 1: 5  
 Tier 2: 2

A's own funds position is as follows:

Tier 1 (Article 69(a)(i), (ii), (iv) and (vi) items): 400  
 Tier 1 (Article 69(a)(iii), (v) and (b) items): 40  
 Tier 2: 50

The corresponding deduction approach is applied as follows:

	Tier 1 (Article 69(a) (i), (ii), (iv) and (vi) of the Implementing Measures items)	Tier 1 (Article 69 (a) (iii), (v) and (b) of the Implementing Measures items)	Tier 2
A	400	40	50
Deduction in respect of B	(40)	(5)	(2)
Available own funds for A	360	35	48

Suppose A owns a participation in financial or credit institution C comprising:

Ordinary shares: 38  
 Subordinated liabilities: 7

This also requires a full deduction but C's own funds are not classified into tiers.

The corresponding deduction is applied as follows:

	Tier 1 (Article 69(a)(i), (ii), (iv) and (vi) of the Implementing Measures items)	Tier 1 (Article 69(a)(iii), (v) and (b) of the Implementing Measures items)	Tier 2
A	400	40	50
Deduction in respect of C	(45)		
Available own funds for A	355	40	50

Suppose A's participation is in financial or credit institution D, its investment comprises:

Common Equity Tier 1: 80

Additional Tier 1: 50

This also gives rise to a full deduction and the corresponding deduction approach is applied as follows:

	Tier 1 (Article 69(a)(i), (ii), (iv) and (vi) of the Implementing Measures items)	Tier 1 (Article 69(a)(iii), (v) and (b) of the Implementing Measures items)	Tier 2
A	400	40	50
Deduction in respect of D	80	50	
<b>Stage 1</b>	(80)	(40)	
	320	Tier 1 (Article 69(a)(iii), (v) and (b) of the Implementing Measures items) is exhausted	
<b>Stage 2</b>			
The remainder of the deduction is made from Tier 1 (Article 69(a)(i), (ii), (iv) and (vi) of the Implementing Measures items)	(10)		
Available own funds for A	310		50

Returning to the example covered in Case 2 above: the deductions calculated on a pro-rated basis are applied as follows.

	Tier 1 (Article 69(a)(i), (ii), (iv) and (vi) of the Implementing Measures items)	Tier 1 (Article 69(a)(iii), (v) and (b) of the Implementing Measures items)	Tier 2
A	400	40	50
Deduction in respect of E	(5.96)	(1.49)	
Deduction in respect of F	(6.86)	(2.09)	0.60
Available own funds for A	387.18	36.42	49.40

**Guideline 7 - Adjustments due to deductions of indirectly-held participations in financial and credit institutions**

Where a deduction of the value of a participation in a financial or credit institution held indirectly is required, in full or in part, in accordance with Article 68 of the Implementing Measures, participating undertakings should, only for the purposes of calculating the SCR:

- (a) reduce, by the amount of that deduction, the value of the directly-held related undertaking, which is an asset of the participating undertaking, through which the participation in the financial or credit institution is held indirectly;
- (b) for the adjustment described in point (a), follow the approach set out in Article 68(5) of the Implementing Measures and in Guideline 6.

2.16. The value of the participating undertaking’s investment in the directly-held related undertaking is not adjusted for the purposes of determining the participating undertaking’s excess of assets over liabilities, i.e. the adjustment is exclusively for the purposes of calculating the SCR. Furthermore, it is not an adjustment to the own funds of the intermediate related undertaking.

2.17. The below example uses the same participating undertaking A as in the explanatory text to Guideline 4 above and continues with the next steps in the calculation.

A needs to calculate its deductions under Article 68 of the Implementing Measures and its inputs to the Standard Formula SCR:

The value of items included in Article 69(a)(i), (ii), (iv), and (vi) of the Implementing Measures is 10,000, meaning that the threshold is 1000.

Considering the inputs for the Article 68 of the Implementing Measures calculation:

- The value of H at 2000 is above the threshold of 1000, so H is deducted in full.
- B and E are less than the threshold on an individual basis.
- The value of B at 500 and E at 700 are in aggregate above the threshold of 1000, giving a deduction of the excess of 200.
- The deduction of 200 is pro-rated between B at 83 and E at 117.

Effect of deductions on inputs to SCR calculations of A:

Name of A’s related undertaking	Value of the related undertaking on a Solvency II basis	Adjustment in respect of deductions direct and indirect	Inputs to SCR calculations of A
B	500	83 (direct)	417
D	5000	117 (indirect re E)	4883
F	6000	2000 (indirect re H)	4000

D, F and G would all have to perform their own calculations for the purposes of Article 68 of the Implementing Measures and the SCR following the same approach.

### **Guideline 8 -Application of the standard formula to related undertakings**

This Guideline applies to participating undertakings using the standard formula to calculate the SCR in respect of the risks arising from related undertakings held directly by the participating undertaking.

Where a participating undertaking holds as assets own fund items of a related undertaking and their value is not deducted in full, or at all, from the participating undertaking's own funds as a result of applying Article 68 of the Implementing Measures, risk charges for the remaining value of those holdings should be calculated in accordance with the standard formula.

The participating undertaking should apply the standard formula as follows:

- (a) holdings in ordinary or preference share capital of the related undertaking should be treated as equities applying the equity risk sub-module as appropriate;
- (b) holdings in subordinated liabilities issued by the related undertaking should be treated as financial instruments taking account of contractual terms and applying market stresses as appropriate, including the interest rate, spread, currency, concentration and other risk sub-modules as appropriate;
- (c) any holdings of the above which exhibit both equity and bond features should be dealt with in accordance with Guideline 5 of the Guidelines on the Treatment of market and counterparty risk exposures in the standard formula.

2.18. Article 68 of the Implementing Measures defines deductions that participating undertakings have to apply if they hold participations in financial and credit institutions.

2.19. Guideline 8 clarifies that when calculating the SCR using the standard formula, investments in related undertakings which are not deducted (i.e. related undertakings other than financial and credit institutions or strategic participations in financial and credit institutions) are subject to standard formula charges as they apply to all other equity investments.

2.20. These examples are intended to illustrate the application of the standard formula in cases in which deductions are not applied:

#### Case 1

Suppose that insurance undertaking A owns a participation in two related undertakings B and C, both of them are other than financial and credit institutions. C is a strategic participation but B is not strategic.

B ordinary shares in A's balance sheet are valued at 40. B issued subordinated liabilities, valued at 10, which are owned by A (the total value of B in A's balance sheet therefore is 50).

C ordinary shares in A's balance sheet are valued at 60.

The value of the related undertakings B and C are not relevant for deductions under Article 68 of the Implementing Measures, because they are not financial and credit institutions.

When calculating the SCR with the standard formula, A has to apply to B's ordinary shares the equity risk charge 39% or 49% depending on the type of equity (cf. Article 168 of the draft Implementing Measures).

Subordinated liabilities issued by B, and owned by A, are charged according to rules for bonds. Equity risk charge to be applied to C as a strategic participation is 22%.

### Case 2

Suppose that insurance undertaking A owns a participation in a related undertaking D, which is a bank that is strategic for A and it is included in the calculation of the group solvency on the basis of method 1 as set out in Annex I to Directive 2002/87/EC.

Total own funds of A are equal to 400 (Tier 1 only).

D ordinary shares in A's balance sheet are valued at 90.

D issued subordinated liabilities, valued at 10, which are owned by A.

The value of the participation D in A's balance sheet (100) is higher than the threshold of 10% set out in Article 68(1) of the Implementing Measures, (equal to 40). However, it is not deducted, because Article 68(3) of the Implementing Measures applies.

When calculating the SCR with the standard formula, A has to apply the equity risk charge of 22% to the value of its holding of D's ordinary shares.

Subordinated liabilities issued by D and owned by A, are charged according to rules for bonds.

### Case 3

The undertaking A owns two participations E and F, which are financial and credit institutions.

Total own funds of A are equal to 400 (Tier 1 only).

The value of the participation E in A's balance sheet is 20 (ordinary shares only).

The value of the participation F in A's balance sheet is 30 (ordinary shares only).

Neither E nor F have issued any subordinated liabilities.

The sum of E and F is 50, higher than the threshold of 40 (10% of 400). Therefore, Article 68(2) of the Implementing Measures applies.

Deductions are equal to 10 (50 – 40).

In particular applying the pro-rata basis ( $10/50 = 0.20$ ) deducted values are:

	Total value	Deduction	Non Deducted Value
E	20	4	16
F	30	6	24
Total	50	10	40

In calculating the SCR with the standard formula, A has to apply to E's and F's non-deducted values the equity risk charge of 39% or 49% depending on the type of equity. No risk charges will be applied to the deducted amounts.

#### Case 4

Suppose that A owns only one participation G which is a bank.

Total own funds of A are equal to 400 (Tier 1 only). G ordinary shares in A's balance sheet are valued at 35. G did not issue subordinated liabilities.

The value of the participation D (35) is lower than the threshold of 10% set out in Article 68(1) of the Implementing Measures, (equal to 40). Therefore, it is not deducted.

When calculating the SCR with the standard formula, A has to apply to its holding of G's ordinary shares (valued at 35) the equity risk charge of 39% or 49% depending on the type of equity.

## **Appendix A - Terms used in Solvency II concerning the relationship between two or more undertakings**

- 2.21. In Solvency II, different terms are used when speaking about the relationship between two or more undertakings.
- 2.22. This appendix only looks at the perspective of undertakings that are held by a participating undertaking. It does not analyse the perspective of the participating undertaking and the terms used for those.

### **The starting point**

- 2.23. Article 92(1)(b) of Solvency II requires the Commission to adopt implementing measures specifying the treatment of participations, within the meaning of the third subparagraph of Article 212(2) of Solvency II, in financial and credit institutions with respect to the determination of own funds.
- 2.24. Article 111(1)(m) of Solvency II requires the Commission to adopt implementing measures providing for the approach to be used with respect to related undertakings within the meaning of Article 212 of Solvency II in the calculation of the SCR using the Standard Formula.
- 2.25. The Guidelines thus cover the treatment of both participations and related undertakings in regard to own funds and the SCR.

### **Terms used and defined in Solvency II**

- 2.26. In Solvency II, different terms are used for undertakings that are held by a participating undertaking:
- The broadest term is "related undertaking". According to Article 212(1)(b) of Solvency II, related undertaking means either a subsidiary undertaking or other undertaking in which a participation is held, or an undertaking linked with another undertaking by a relationship as set out in Article 12(1) of Directive 83/349/EEC.
  - The definition of related undertaking employs the term "subsidiary". According to Article 13(16) of Solvency II, subsidiary undertaking means any subsidiary undertaking within the meaning of Article 1 of Directive 83/349/EEC including subsidiaries thereof.

According to Article 212(2) second subparagraph of Solvency II, supervisory authorities shall also consider as a subsidiary undertaking any undertaking over which, in the opinion of the supervisory authorities, a parent undertaking effectively exercises a dominant influence.

- The term "participation" means the ownership, direct or by way of control, of 20% or more of the voting rights or capital of an undertaking, according to Article 13(20) of Solvency II.

According to Article 212(2) third subparagraph of Solvency II, supervisory authorities shall also consider as participation the holding, directly or indirectly,

of voting rights or capital in an undertaking over which, in the opinion of the supervisory authorities, a significant influence is effectively exercised.

- “Undertaking linked with another undertaking by a relationship as set out in Article 12(1) of Directive 83/349/EEC” is another sub-term of “related undertaking”.

Article 12 of Directive 83/349/EEC reads as follows:

“1. Without prejudice to Articles 1 to 10, a Member State may require any undertaking governed by its national law to draw up consolidated accounts and a consolidated annual report if:

- (a) that undertaking and one or more other undertakings with which it is not connected, as described in Article 1(1) or (2), are managed on a unified basis pursuant to a contract concluded with that undertaking or provisions in the memorandum or articles of association of those undertakings; or
- (b) the administrative, management or supervisory bodies of that undertaking and of one or more other undertakings with which it is not connected, as described in Article 1(1) or (2), consist for the major part of the same persons in office during the financial year and until the consolidated accounts are drawn up.”

## **Appendix B - The meaning of the term financial and credit institutions**

- 2.27. The provision of Article 68 of the Implementing Measures that specifically deals with the treatment of participations in the determination of basic own funds only refers to participations, as referred to in Article 92(2) of Solvency II, in a financial or credit institution. Article 92(2)(a) of Solvency II rules that participations in financial and credit institutions shall comprise credit institutions and financial institutions within the meaning of Article 4(1) and (5) of Directive 2006/48/EC and investment firms within the meaning of point 1 of Article 4 (1) of Directive 2004/39/EC.
- 2.28. According to Article 163 of Directive 2013/36/EU (hereinafter "CRD IV"), Directive 2006/48/EC is repealed with effect from 1 January 2014. References to the repealed Directive shall be construed as references to the CRD IV and to Regulation (EU) No 575/2013 and shall be read in accordance with the correlation table set out in Annex II to the CRD IV and in Annex IV to Regulation (EU) No 575/2013 (hereinafter "CRR"). According to the correlation table, Article 4 of Directive 2006/48/EC becomes Article 3 of CRD IV.

### **Credit institution**

- 2.29. Article 3(1) of CRD IV reads that credit institution means credit institution as defined in point (1) of Article 4(1) of CRR.
- 2.30. Article 4(1)(1) of CRR defines credit institution as follows:  
"Credit institution means an undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account".

### **Financial institution**

- 2.31. Article 3(22) of CRD IV reads that financial institution means financial institution as defined in point (26) of Article 4(1) of CRR.
- 2.32. Article 4(1)(26) of CRR defines financial institution as follows:  
"financial institution means an undertaking other than an institution, the principal activity of which is to acquire holdings or to pursue one or more of the activities listed in points 2 to 12 and point 15 of Annex I to Directive 2013/36/EU, including a financial holding company, a mixed financial holding company, a payment institution within the meaning of Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market (1), and an asset management company, but excluding insurance holding companies and mixed-activity insurance holding companies as defined in point (g) of Article 212(1) of Directive 2009/138/EC."
- 2.33. According to Article 4(1)(20) of CRR, financial holding company means a financial institution, the subsidiaries of which are exclusively or mainly institutions or financial institutions, at least one of such subsidiaries being an institution, and which is not a mixed financial holding company.

- 2.34. The term institution is defined in Article 4(1)(3) of CRR and shall mean a credit institution or an investment firm.
- 2.35. According to Article 4(1)(21) of CRR a mixed financial holding company means a mixed financial holding company as defined in point (15) of Article 2 of Directive 2002/87/EC, where is stated: "mixed financial holding company means a parent undertaking, other than a regulated entity, which, together with its subsidiaries – at least one of which is a regulated entity which has its registered office in the Union – and other entities, constitutes a financial conglomerate".
- 2.36. The term asset management company means, according to Article 4(1)(19) of CRR, an asset management company as defined in point (5) of Article 2 of Directive 2002/87/EC and an AIFM as defined in Article 4(1)(b) of Directive 2011/61/EU, including, unless otherwise provided, third country entities, that carry out similar activities, that are subject to the laws of a third country which applies supervisory and regulatory requirements at least equivalent to those applied in the Union.
- 2.37. According to point (f) of Article 212(1) of Solvency II, insurance holding company means a parent undertaking which is not a mixed financial holding company within the meaning of Directive 2002/87/EC and the main business of which is to acquire and hold participations in subsidiary undertakings, where those subsidiary undertakings are exclusively or mainly insurance or reinsurance undertakings, or third-country insurance or reinsurance undertakings, at least one of such subsidiary undertakings being an insurance or reinsurance undertaking.
- 2.38. According to point (g) of Article 212(1) of Solvency II, mixed-activity insurance holding company means a parent undertaking, other than an insurance undertaking, a third-country insurance undertaking, a reinsurance undertaking, a third-country reinsurance undertaking, an insurance holding company or a mixed financial holding company within the meaning of Directive 2002/87/EC, which includes at least one insurance or reinsurance undertaking among its subsidiary undertakings.
- 2.39. Points 2 to 12 and point 15 of Annex I to CRD IV read as follows:
2. Lending including, inter alia: consumer credit, credit agreements relating to immovable property, factoring, with or without recourse, financing of commercial transactions (including forfeiting).
  3. Financial leasing.
  4. Payment services as defined in Article 4(3) of Directive 2007/64/EC.
  5. Issuing and administering other means of payment (e.g. travellers' cheques and bankers' drafts) insofar as such activity is not covered by point 4.
  6. Guarantees and commitments.
  7. Trading for own account or for account of customers in any of the following:

- (a) money market instruments (cheques, bills, certificates of deposit, etc.);
- (b) foreign exchange;
- (c) financial futures and options;
- (d) exchange and interest-rate instruments;
- (e) transferable securities.

8. Participation in securities issues and the provision of services relating to such issues.

9. Advice to undertakings on capital structure, industrial strategy and related questions and advice as well as services relating to mergers and the purchase of undertakings.

10. Money broking.

11. Portfolio management and advice.

12. Safekeeping and administration of securities.

15. Issuing electronic money.”

## **Investment firms**

2.40. Investment firm within the meaning of point 1 of Article 4(1) of Directive 2004/39/EC means any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis. According to point 1 of Article 4(1) of Directive 2004/39/EG, “Member States may include in the definition of investment firms undertakings which are not legal persons, provided that:

(a) their legal status ensures a level of protection for third parties' interests equivalent to that afforded by legal persons, and

(b) they are subject to equivalent prudential supervision appropriate to their legal form.

However, where a natural person provides services involving the holding of third parties' funds or transferable securities, he may be considered as an investment firm for the purposes of this Directive only if, without prejudice to the other requirements imposed in this Directive and in Directive 93/6/EEC, he complies with the following conditions:

(a) the ownership rights of third parties in instruments and funds must be safeguarded, especially in the event of the insolvency of the firm or of its proprietors, seizure, set-off or any other action by creditors of the firm or of its proprietors;

(b) the firm must be subject to rules designed to monitor the firm's solvency and that of its proprietors;

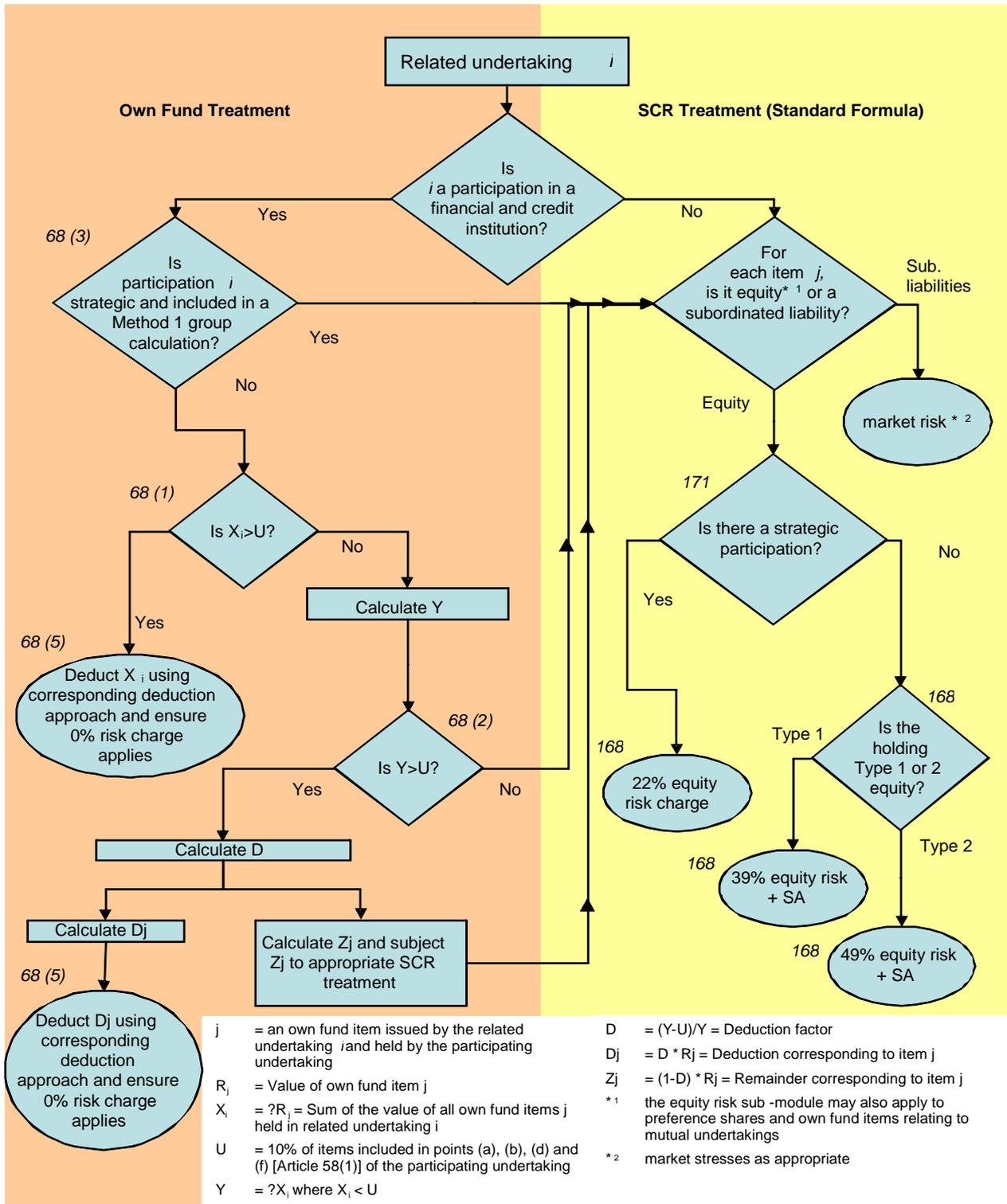
(c) the firm's annual accounts must be audited by one or more persons empowered, under national law, to audit accounts;

(d) where the firm has only one proprietor, he must make provision for the protection of investors in the event of the firm's cessation of business following his death, his incapacity or any other such event."

## **Appendix C - Summary of the treatment of all types of related undertakings**

2.41. The charts 1 and 2 below reflect the treatment of related undertakings using the standard formula and an internal model respectively. They reflect direct ownership only; additional analysis and calculations will be necessary for participations in financial and credit institutions held indirectly.

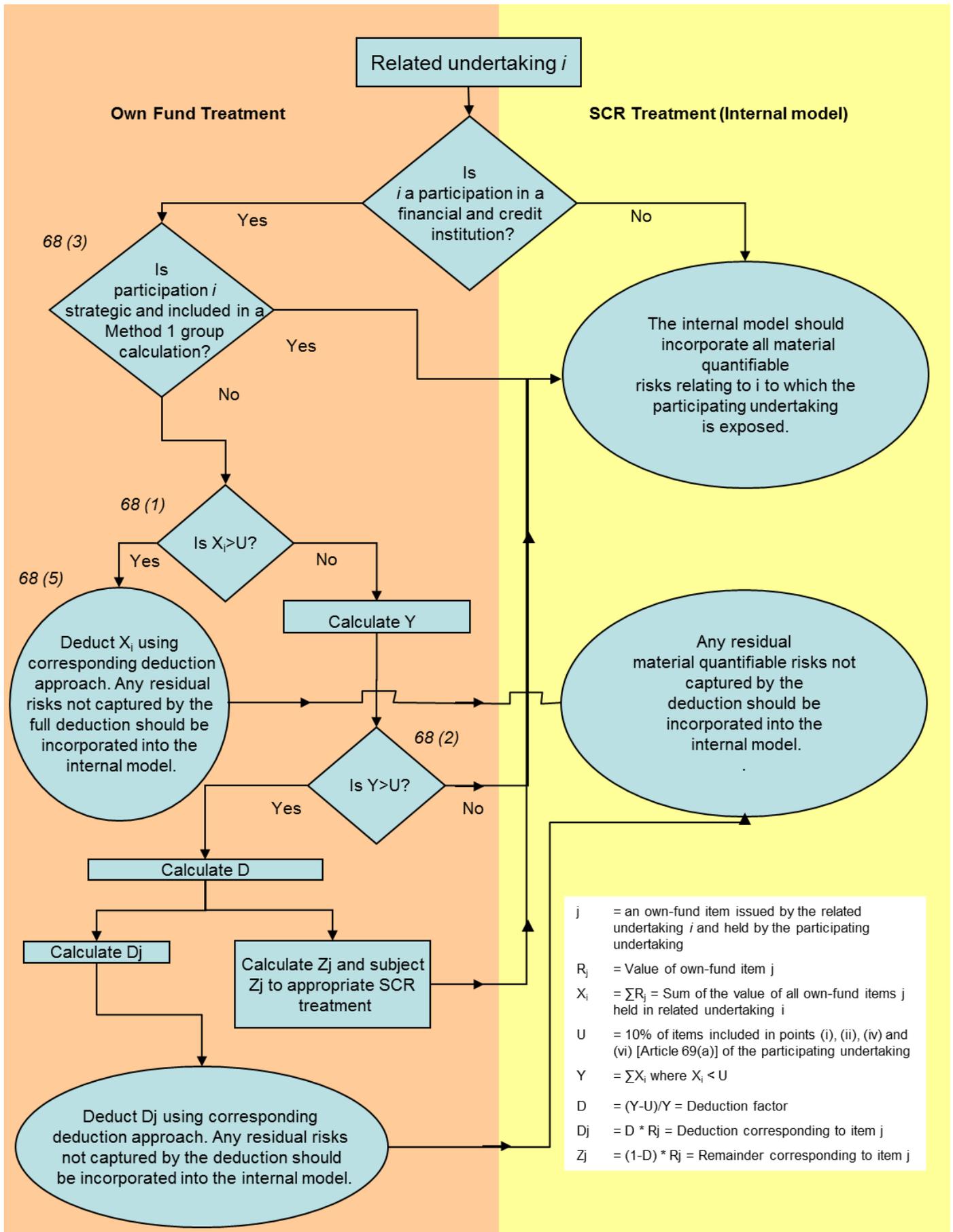
**Chart 1: Treatment when using the standard formula**



$j$  = an own fund item issued by the related undertaking *i* and held by the participating undertaking  
 $R_j$  = Value of own fund item  $j$   
 $X_i$  =  $\sum R_j$  = Sum of the value of all own fund items  $j$  held in related undertaking *i*  
 $U$  = 10% of items included in points (a), (b), (d) and (f) [Article 58(1)] of the participating undertaking  
 $Y$  =  $\sum X_i$  where  $X_i < U$

$D$  =  $(Y-U)/Y$  = Deduction factor  
 $D_j$  =  $D * R_j$  = Deduction corresponding to item  $j$   
 $Z_j$  =  $(1-D) * R_j$  = Remainder corresponding to item  $j$   
<sup>\*1</sup> the equity risk sub -module may also apply to preference shares and own fund items relating to mutual undertakings  
<sup>\*2</sup> market stresses as appropriate

**Chart 2: Treatment when using an internal model**



$j$  = an own-fund item issued by the related undertaking  $i$  and held by the participating undertaking  
 $R_j$  = Value of own-fund item  $j$   
 $X_i$  =  $\sum R_j$  = Sum of the value of all own-fund items  $j$  held in related undertaking  $i$   
 $U$  = 10% of items included in points (i), (ii), (iv) and (vi) [Article 69(a)] of the participating undertaking  
 $Y$  =  $\sum X_i$  where  $X_i < U$   
 $D$  =  $(Y-U)/Y$  = Deduction factor  
 $D_j$  =  $D * R_j$  = Deduction corresponding to item  $j$   
 $Z_j$  =  $(1-D) * R_j$  = Remainder corresponding to item  $j$