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

CSSF Regulation N° 14-02 relating to the determination of distributable results and reserves of credit institutions applying the fair value measurement in the statutory accounts

(Mémorial A - No 4 of 9 January 2015)

The Executive Board of the Commission de Surveillance du Secteur Financier,

Having regard to Article 108a of the Constitution;

Having regard to the Law of 23 December 1998 establishing a financial sector supervisory commission ("Commission de surveillance du secteur financier") and in particular Articles 2(5) and 9(2) thereof;

Having regard to the Law of 17 June 1992 relating to the annual and consolidated accounts of credit institutions governed by the laws of Luxembourg and the obligations regarding publication of the accounting documents of branches of credit institutions and financial institutions governed by foreign laws, and in particular Articles 64a to 64e (Chapter 7a of Part II) and 76a (Part IIa) thereof;

Having regard to the Law of 5 April 1993 on the financial sector, and in particular Articles 1(12) and 12 thereof;

Having regard to the opinion of the Consultative Committee for the Prudential Regulation;

Decides:

Part I
Scope

Article 1
Scope

This Regulation shall apply to all credit institutions established under Luxembourg law as defined in the law of 5 April 1993 on the financial sector.

Part II
Limitation of the ability of credit institutions to distribute unrealised results and reserves

Article 2
Credit institutions choosing to apply Chapter 7a of Part II of the law of 17 June 1992 (use of the fair value option in the statutory accounts)

(1) When applying the fair value measurement in accordance with Chapter 7a of Part II of the law of 17 June 1992, deferred tax liabilities shall be recognised in the balance sheet, provided that the gain related to the increase in the fair value of an eligible asset or liability is taxable when realised. The notes to the accounts shall include the cumulative amount of deferred tax liabilities; this amount may also be shown on the face of the balance sheet as a cumulative amount under a separate item in an appropriate heading.

(2) When applying the fair value measurement in accordance with Chapter 7a of Part II of the law of 17 June 1992, the provisions of Article 3 of this Regulation shall apply.

Article 3
Credit institutions choosing to apply Part IIa of the law of 17 June 1992 (use of the international accounting standards IAS/IFRS in the statutory accounts)

(1) Credit institutions applying Part IIa of the law of 17 June 1992 may not distribute or use for another purpose:

- a) unrealised revenue and gains, net of related tax, recognised in the profit and loss account;
- b) unrealised revenue and gains, net of related tax, recognised in equity without affecting the profit and loss account;
- c) positive changes in equity, net of related tax, recorded in the opening balance sheet of the first annual accounts drawn up in accordance with Part IIa or upon the first-time adoption of a standard to an asset or liability category or item or to a defined equity instrument.

(2) The items specified in paragraph (1) above shall be allocated to an unavailable reserve either directly upon their recognition or indirectly upon the appropriation of the results of the financial year. This unavailable reserve may not be used for the following purposes or for similar purposes:

- a) capital increase by incorporation of reserves;
- b) allocation to the legal reserve;
- c) creation of the unavailable reserve in relation to the acquisition of own shares;
- d) creation of the unavailable reserve in relation to the financial assistance for acquisition of the company's shares by third parties;
- e) creation of the unavailable reserve in relation to the issue of redeemable shares;
- f) determination of the loss of half or three quarters of the share capital;
- g) special reserve created in accordance with paragraph (8a) of the law of 16 October 1934 on wealth tax.

(3) By way of derogation from paragraphs (1) and (2) above, the following items shall not be considered as unavailable and, as a consequence, may be distributed or used for another purpose:
   (a) unrealised gains referred to in paragraph (1)(a) related to financial instruments held as trading book items as well as to changes in exchange rates and changes within the scope of a fair value hedge accounting system;
   b) changes in equity referred to in paragraph (1)(c) related to reversals of provisions and value adjustments, other than those calculated in order to systematically depreciate the value of asset items over their useful economic lives, which cannot be kept in the balance sheet drawn up in accordance with Part IIa of the law of 17 June 1992; the provisions of this paragraph shall neither apply to the lump sum provision nor to the AGDL provision for which the CSSF lays down specific instructions.

(4) Should the result of the financial year be lower than the amount of unrealised revenue and gains, net of related tax, referred to in paragraph (1)(a), the unavailable reserve referred to in paragraph (2) shall be made up, for the difference, by using available reserves, or otherwise, by using retained earnings.

(5) The unavailable reserve referred to in paragraph (2) shall be released as the revenue, gains and positive changes referred to in paragraph (1) are realised, for the corresponding amount, including through systematic depreciation, or when revaluation gains decrease following value adjustment.

(6) For any other case not covered by this article, reference is made to the general principle laid down in Article 51(1)(c) of the law of 17 June 1992 being the principle of prudence and profit realisation.

Part III
Other provisions

Article 4
Entry into force

Credit institutions shall apply the provisions of this Regulation as from the financial years ending on 31 December 2014.

Article 5
Publication

This Regulation shall be published in the Mémorial and on the website of the Commission de Surveillance du Secteur Financier.

Luxembourg, 19 December 2014

COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER

Claude SIMON	Andrée BILLON	Simone DELCOURT	Jean GUILL
Director	Director	Director	Director general

Explanatory memorandum

The law of 30 July 2013 reforming the Commission des normes comptables and amending various provisions relating to accounting and the annual accounts of companies, as well as to the consolidated accounts of certain types of firms (hereinafter the CNC Law, draft bill no 6376), amending the law of 19 December 2002 concerning the trade and companies register as well as the accounting and annual accounts of companies (hereinafter the TCR Law), introduced rules to determine the distributable reserves when companies use the fair value measurement in the statutory accounts drawn up according to Lux GAAP - mixed regime (new Article 64h referring to the new Article 72b) or in the statutory accounts drawn up according to IFRS (new Article 72b).

This CSSF Regulation applies the provisions of the new Article 72b/64h of the TCR Law to the credit institutions. It shall be read jointly with the provisions of Circular CSSF 08/340 (points I.2.3 and I.3.1) pursuant to which unrealised gains arising from the fair value measurement of certain balance sheet items and recognised in a revaluation reserve, are not distributable (qualified as unavailable), and with the provisions of CSSF Regulation N° 14-01 on the implementation of certain discretions of Regulation (EU) No 575/2013, pursuant to which unrealised gains arising from the fair value measurement shall not be included in the calculation of Common Equity Tier 1 in the years 2014 to 2017 (cf. Article 8).

The provisions of this CSSF Regulation shall apply to the financial years ending on 31 December 2014 and later.

Comments on the articles

Comment on Article 2:

By analogy with Article 65(1) point 11°(b) introduced by the CNC Law of 30 July 2013 into the TCR Law, Article 2(1) of this CSSF Regulation lays down, for credit institutions drawing up their annual accounts according to the national accounting regime and choosing to apply the options provided for in Chapter 7a entitled "Valuation at fair value" (Lux GAAP: mixed regime), the principle whereby deferred tax liabilities are to be recognised in the balance sheet (an amount of income tax attributable to the accounting profit of the current financial year, but which will only be payable in a future period). Deferred tax liabilities are mandatory to be recognised in the balance sheet when Chapter 7a relating to the fair value measurement is applied, provided that the gain related to the increase in the fair value of an eligible asset or liability is taxable when realised.

For additional details in this area, reference is made to the draft bill no 6376 (comment on Article 2; no 23, 4th indent).

By analogy with Article 64h introduced by the CNC Law of 30 July 2013 into the TCR Law, Article 2(2) of this CSSF Regulation refers to Article 3 of this CSSF Regulation to ensure that the provisions governing the distribution of unrealised results and reserves apply not only to credit institutions drawing up their annual accounts according to the international accounting standards IFRS, but also to credit institutions drawing up their annual accounts according to the national accounting regime and choosing to apply the options provided for in Chapter 7a entitled "Valuation at fair value" (Lux GAAP: mixed regime).

For additional details in this area, reference is made to the draft bill no 6376 (comment on Article 2; no 22).

Comment on Article 3:

By analogy with Article 72b introduced by the CNC Law of 30 July 2013 into the TCR Law, Article 3 of this CSSF Regulation lays down the principle whereby the ability of credit institutions to distribute unrealised results and reserves is limited, when their annual accounts are drawn up according to the international accounting standards IFRS. Article 3 also applies to credit institutions drawing up their annual accounts according to the national accounting regime and choosing to apply the options provided for in Chapter 7a entitled "Valuation at fair value" (Lux GAAP: mixed regime).

The new concept laid down in the TCR Law (Article 72b), with the aim of protecting shareholders and creditors of the company, is based on two principles:

- the first principle allows fully or nearly realised gains (recognised in the profit and loss account) to be distributed;
- the second principle requires unrealised gains (recognised in the profit and loss account or in a revaluation reserve) to be allocated to a non-distributable reserve (unavailable) reserve.

The purpose of paragraph (1) of Article 3 is to lay down the principle whereby any unrealised item increasing the accounting equity of credit institutions is to be non-distributable and is to be allocated to an unavailable reserve (for the amount net of current tax or more probably deferred tax), namely:

- letter (a): annual revaluations (net of current/deferred tax) affecting the profit and loss account. *Examples*: unrealised gains on investment property;

- letter (b): annual revaluations (net of current/deferred tax) not affecting the profit and loss account, but directly recorded in the revaluation reserves within equity. *Examples*: unrealised gains on available-for-sale financial assets, on cash-flow hedging derivatives or on owner-occupied property;

- letter (c): revaluations/changes of equity (net of current/deferred tax) recognised in revaluation reserves or in retained earnings, whichever applies, in relation to the first-time adoption of the IFRS standards, a new IFRS standard or a new accounting policy, where IFRS standards require a retrospective application affecting the results and reserves of prior periods/opening balance sheet.

The purpose of paragraph (2) of Article 3 is to specify that in addition to the prohibition to distribute unrealised items (cf. paragraph (1) above) it is prohibited to use for other purposes any unrealised item increasing accounting equity of credit institutions. *Examples*: capital increase by incorporation of reserves; allocation to the legal reserve; etc.

The purpose of paragraph (3) of Article 3 is to specify certain exceptions to the principle of non-distribution of unrealised items recognised in the profit and loss account, namely:

- letter (a): unrealised gains on financial instruments held in the trading portfolio recognised in the profit and loss account (gains considered as nearly realised: short-term holdings) and unrealised gains related to certain other items recognised in the profit and loss account, namely: (i) changes related to currency fluctuations (need for a monitoring outside the accounting for identifying unrealised items); (ii) changes in value on the hedged items as well as those (of opposite sign) on the hedging derivatives where fair value hedge accounting rules are applied (the unrealised gains and losses recognised in the profit and loss account being supposed to offset each other);

- letter (b): changes in equity (net of current/deferred tax) registered upon the first-time adoption of IFRS directly in retained earnings (cf. paragraph (1)(c) above), related to reversals of value adjustments or provisions recorded according to Lux GAAP, but not admitted according to IFRS. This concerns reversals of provisions and value adjustments admitted according to Lux GAAP (foreseeable liabilities and potential losses) but which do not meet the definition of value adjustments or provisions that may be recorded as expenses according to IFRS. The provisions of paragraph (3), letter (b) neither apply to the lump sum provision nor to the AGDL provision for which the CSSF lays down specific instructions in a separate circular.

The purpose of paragraph (4) of Article 3 is to specify the methods to allocate the unavailable reserve in the particular case where the result of the financial year is lower than the unrealised gains recognised in the profit and loss account. Unrealised gains (not distributable) are to be deducted from accounting reserves (= profit or loss for the financial year + profit or loss brought forward + other reserves + revaluation reserves); the non-distributable amount (net of tax) is to be allocated to an unavailable reserve. If the result of the financial year is not sufficient for the amount to be allocated to the unavailable reserve (unrealised gains > result of the financial year: in particular where the other operations of the institution would have generated a loss), the unavailable reserve is to be allocated through use of retained earnings or other available reserves (through creation of a debit carried forward, as the case may be, to be cleared before subsequent distribution).

The purpose of paragraph (5) of Article 3 is to specify circumstances permitting to release the unavailable reserve with the aim of making it distributable. *Examples*: disposal of an asset that gave rise to the revaluation; decrease in an asset's fair value. A table retracing the movements of the unavailable reserve will thus be necessary in order to ensure proper and thorough monitoring.

The purpose of paragraph (6) of Article 3 is to specify the treatment of the cases that are not expressly covered by Article 3(1) to (5). When in doubt and by default, the principle of prudence and non-distribution of unrealised gains is to be applied. According to this approach, the negative revaluation recorded within equity are to be deducted from available reserves before distribution.

For additional details in this area, reference is made to the draft bill no 6376 (comment on Article 2; no 33).

Comments on Articles 1, 4 and 5:

Articles 1, 4 and 5 of this CSSF Regulation do not call for any specific comments.