

**COMMISSION de SURVEILLANCE  
du SECTEUR FINANCIER**

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

Luxembourg, 19 December 2014

To all credit institutions

**CIRCULAR CSSF 14/599**

**Re: Treatment of the lump sum provision and the AGDL provision in the prudential reporting**

Ladies and Gentlemen,

1. The purpose of this circular is to inform the credit institutions of an alignment of the treatment of the lump sum provision and the AGDL provision in the prudential reporting following the implementation of Regulation (EU) No 575/2013 (CRR).<sup>1</sup>

This involves the following three points:

- technical alignment in the FINREP following the harmonisation of the European reporting;
  - alignment of the treatment of the lump sum provision with regard to own funds;
  - clarification of the transition from a deposit guarantee scheme supplied with provisions to a deposit guarantee scheme supplied ex ante with payments in a fund.
2. Until now, according to the instructions on the FINREP to be drawn up according to IFRS (International Accounting Standards), the lump sum and AGDL provisions were recognised in the income statement (expenses) in counterpart of a liability item. Moreover, with regard to the COREP applicable until 31.12.2013, neither the lump sum provision nor the AGDL provision were part of the prudential own funds.

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<sup>1</sup> Cf. also Circular CSSF 14/593 on the supervisory reporting requirements applicable to credit institutions as from 2014.

3. Pursuant to Article 24, paragraph 2 of the CRR<sup>2</sup>, the CSSF requires the credit institutions to value the risk weighted assets and determine the own funds for the consolidated and non-consolidated COREP in accordance with IFRS as adopted by the European Union. The principle being that the risk weighted assets and the own funds shall be extracted from the FINREP, it is obvious that the consolidated and non-consolidated FINREP shall comply with IFRS as adopted by the European Union. Thus, the CSSF must change the accounting treatment for the lump sum and AGDL provisions in the consolidated and non-consolidated FINREP so that the FINREP complies with IFRS as adopted by the European Union.

Indeed, the lump sum provision and the AGDL provision differ from the definition of impairment (value adjustments) within the meaning of IAS 39 (incurred loss) or a provision within the meaning of IAS 37 (obligation to a third party), which can be recognised as expenses according to IFRS; they are retained earnings.

Therefore, the following treatment shall henceforth apply to the lump sum and AGDL provisions for the prudential reporting:

#### I) TREATMENT OF THE LUMP SUM PROVISION

4. As regards FINREP, transfers to the lump sum provision shall be recognised in an unavailable reserve (for net of tax)<sup>3</sup>. This reserve may only be used for the purposes it was conceived<sup>4</sup>.
5. Depending on the version of the applicable FINREP, the unavailable reserve (for net of tax) with respect to the lump sum provision shall be recognised as follows:
  - **Consolidated FINREP (Common European Reporting, version applicable as from 01.07.2014):**  
Table F 03.00, row 230 "Other reserves - Other";
  - **Non-consolidated FINREP (version introduced on 01.01.2008 by the CSSF):**  
Table B 1.3, row 3.5 "Reserves (including retained earnings)".
6. For the purposes of the regulation on solvency (COREP), the reserve with respect to the lump sum provision shall be eligible under Common Equity Tier 1 capital (CET1), in

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<sup>2</sup> Article 24 of the CRR "Valuation of assets and off-balance sheet items" provides that:

1. The valuation of assets and off-balance sheet items shall be effected in accordance with the applicable accounting framework.
2. By way of derogation from paragraph 1, competent authorities may require that institutions effect the valuation of assets and off-balance sheet items and the determination of own funds in accordance with International Accounting Standards as applicable under Regulation (EC) No 1606/2002.

<sup>3</sup> At the date of the first adoption of the new accounting regime, as regards particularly the non-consolidated FINREP, the existing lump sum provision shall be transferred in the balance sheet (table B 1.1) from row 2.8.99 "Other provisions" to row 3.5 "Reserves (including retained earnings)" (for net of tax) and to row 2.9 "Tax liabilities" without affecting the income statement.

<sup>4</sup> The purpose of the lump sum provision is to cover the risks which are likely to be incurred, but not yet identified when drawing up the balance sheet (i.e. absorb impairment on financial assets or other losses as soon as they occur).

accordance with Article 26, paragraph 1 of the CRR<sup>5</sup>, which provides that the items included in Common Equity Tier 1 capital (CET1) shall be available for immediate and unrestricted use to cover risks and losses as soon as they occur.

Indeed, the reserve with respect to the lump sum provision whose purpose is to cover risks, which are likely to be incurred, but not yet identified when drawing up the balance sheet, may be used immediately and without restriction by the institution to cover risks or losses as soon as they occur. For reasons of prudence, the use of this reserve shall be subject to prior authorisation by the competent authority pursuant to Article 77 of the CRR.

7. As regards COREP, the amount corresponding to the reserve with respect to the lump sum provision (for net of tax) shall be included in item "Other reserves" (row 200) of table C01.00.

Based on the above, the accounting treatment applicable in this area to the FINREP shall be as follows:

**(i) Banks disclosing their corporate financial statements according to IFRS**

8. As a reminder, in the corporate financial statements drawn up according to IFRS, the voluntary transfers to an unavailable reserve (net of tax) with respect to a lump sum provision shall constitute profit appropriations to be approved by the shareholder meeting; the uses of this reserve shall also be approved by the shareholder meeting.
9. As regards FINREP, the decision (year N) to build up a reserve with respect to a lump sum provision or to use it shall be reflected in a movement in the reserves during the subsequent financial year (year N+1) after appropriation of the result disclosed for the last financial year (year N).

In the event of incurred losses (year N), the principle is that the existing unavailable reserve with respect to a lump sum provision shall be released for the losses incurred (recognised as expenses of year N) via transfer to free reserves or retained earnings (year N+1).

**(ii) Banks disclosing their corporate financial statements according to Lux GAAP**

10. As a reminder, in the financial corporate statements drawn up according to Lux GAAP, the transfers to the lump sum provision and their reversals shall constitute expenses and income recognised in the income statement of the financial year to which they refer.

In case of incurred losses (year N), the principle is that the existing lump sum provision shall be used as the losses incurred are booked as expenses (year N) via transfer to the income statement (gains) (year N).

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<sup>5</sup> Article 26, paragraph 1 of the CRR "Common Equity Tier 1 items" provides that:

The items referred to in points (c) to (f) [i.e. retained earnings, accumulated other comprehensive income, other reserves and funds for general banking risk] shall be recognised as Common Equity Tier 1 only where they are available to the institution for unrestricted and immediate use to cover risks or losses as soon as these occur.

11. As regards FINREP, the decision (year N) to build up a lump sum provision or to use it shall be reflected in a movement in the reserves during the subsequent financial year (year N+1), although the movement in the reserves only constitutes a purely technical entry not representing any appropriation of the result disclosed for the last financial year (year N).

In the event of incurred losses (year N), the principle is that the existing unavailable reserve with respect to a lump sum provision shall be released for the losses incurred (recognised as expenses of year N) via transfer to free reserves or retained earnings (year N+1), a purely technical entry not representing any appropriation of the result disclosed for the last financial year (year N).

## II) TREATMENT OF THE AGDL PROVISION

12. As regards FINREP, transfers to the AGDL provision shall be recognised in an unavailable reserve (for net of tax)<sup>6</sup>. This unavailable reserve may only be used for the purposes it was conceived<sup>7</sup>.

13. Depending on the version of the applicable FINREP, the unavailable reserve (for net of tax) with respect to the AGDL provision shall be recognised as follows:

- **Consolidated FINREP (Common European Reporting version applicable as from 01.07.2014):**  
Table F 03.00, row 230 "Other reserves - Other";
- **Non-consolidated FINREP (version introduced on 01.01.2008 by the CSSF):**  
Table B 1.3, row 3.5 "Reserves (including retained earnings)".

14. For the purposes of the regulation on solvency (COREP), the reserve with respect to the AGDL provision shall not be eligible under Common Equity Tier 1 capital (CET1), in accordance with the last sub-paragraph of Article 26, paragraph 1 of the CRR, which provides that the items included in Common Equity Tier 1 capital (CET1) shall be available for immediate and unrestricted use to cover the risks and losses as soon as they occur.

15. As regards COREP, the amount corresponding to the reserve with respect to the AGDL provision (for net of tax) shall be included in the item "Other reserves" (row 200) of table

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<sup>6</sup> At the date of the first adoption of the new accounting regime, as regards particularly the non-consolidated FINREP, the existing AGDL provision shall be transferred in the balance sheet (table B 1.1) from row 2.8.99 "Other provisions" to row 3.5 "Reserves (including retained earnings)" (for net of tax) and to row 2.9 "Tax liabilities" without affecting the income statement.

<sup>7</sup> The purpose of the AGDL provision is to be used in order to contribute to the AGDL (Association pour la Garantie des Dépôts Luxembourg) in the event of insolvency coverage by the latter. The AGDL provision is limited to 10% (minimum provision: 1%) of the amount of the guaranteed cash deposits registered with a bank and eligible under the guarantee scheme. Moreover, the existing AGDL provision shall allow:

- (i) the migration without difficulties from a system of provisioning potential claims of the national deposit guarantee scheme in the balance sheet to a system of pre-financing potential claims by contributing to a national deposit guarantee scheme;
- (ii) where applicable, the contribution to the future National Resolution Fund and/or the Single Bank Resolution Fund.

C01.00 and shall be then deducted in the item "CET1 capital elements or deductions - other" (row 529) of table C01.00.

Based on the above, the accounting treatment applicable in this area to the FINREP shall be as follows:

**(i) Banks disclosing their corporate financial statements according to IFRS**

16. As a reminder, in the corporate financial statements drawn up according to IFRS, the compulsory or other transfers to an unavailable reserve (net of tax) with respect to an AGDL provision shall constitute profit appropriations to be approved by the shareholder meeting; the uses of this reserve shall also be approved by the shareholder meeting.

There are no objections to banks transferring free reserves to an unavailable reserve, up to the estimated amount to be paid to the new national deposit guarantee scheme<sup>8</sup>, <sup>9</sup> (minimum transfer = 1% of the guaranteed deposits); in case the free reserves are insufficient for this purpose, the profit of the financial year shall be put aside to cover the deficit.

17. As regards FINREP, the decision (year N) to build up a reserve with respect to an AGDL provision or to use it shall be reflected in a movement in the reserves during the subsequent financial year (year N+1) after appropriation of the result disclosed for the last financial year (year N).

In the event of claims (year N), the principle is that the existing unavailable reserve with respect to an AGDL provision shall be released for the payments made (recognised as expenses of year N) via transfer to free reserves or retained earnings (year N+1).

18. In case of cash contributions to the new national deposit guarantee scheme<sup>10</sup>, the accounting treatment to be applied in this matter to the FINREP and in the published accounts shall be as follows:

- The cash contributions under the new national deposit guarantee scheme shall be booked as expenses of the financial year to which they refer (year N), whereas the release of the existing AGDL reserve (for net of tax) shall only be carried out during the subsequent financial year (year N+1), following the approval of the profit

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<sup>8</sup> As provided for by Directive 2014/49/EC of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (recast).

<sup>9</sup> The treatment to be applied to cash contributions related to the future National Resolution Fund (as provided for by Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and by Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010), as well as related to the Single Bank Resolution Fund (as provided for by Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010) will be set later by the CSSF.

<sup>10</sup> The treatment to be applied to the cash contributions under the future National Resolution Fund and under the Single Bank Resolution Fund will be set later by the CSSF.

appropriation by the shareholder meeting. In this area, the following principle shall apply: the existing unavailable reserve with respect to an AGDL provision shall be released for the cash contributions made (recognised as expenses of year N) via transfer to free reserves (year N+1) until the unavailable reserve is brought back to zero.

**(ii) Banks disclosing their corporate financial statements according to Lux GAAP**

19. As a reminder, in the financial corporate statements drawn up according to Lux GAAP, the transfers to the AGDL provision and their reversals shall constitute expenses and income recognised in the income statement of the financial year to which they refer.

In the event of claims (year N), the principle is that the existing AGDL provision shall be used as the payments are made (year N) without affecting the income statement (year N), until the provision is brought back to zero; then, the payments made shall be recognised as expenses.

20. As regards FINREP, the decision (year N) to build up an AGDL provision or to use it shall be reflected in a movement in the reserves during the subsequent financial year (year N+1), although the movement in the reserves only constitutes a purely technical entry not representing any appropriation of the result disclosed for the last financial year (year N).

In the event of claims (year N), the principle is that the existing unavailable reserve with respect to an AGDL provision shall be released for the payments made (recognised as expenses of year N) via transfer to free reserves or retained earnings (year N+1), a purely technical entry not representing any appropriation of the result disclosed for the last financial year (year N).

21. In case of cash contributions to the new national deposit guarantee scheme<sup>11</sup>, the accounting treatment to be applied in this matter to the FINREP and in the published accounts shall be as follows:

- In the corporate financial statements, the cash contributions under the new national deposit guarantee scheme shall constitute a use of the existing AGDL provision, without affecting the profit or loss. In this area, the following principle shall apply: first, the existing AGDL provision shall be used as the cash contributions are made (without affecting the income statement) until the provision is brought back to zero; then, the cash contributions shall only be recognised as expenses of the financial year to which they refer.
- As regards FINREP, the cash contributions under the new national deposit guarantee scheme shall be booked as expenses of the financial year to which they refer (year N), whereas the release of the existing AGDL reserve (for net of tax) shall only be carried out during the subsequent financial year (year N+1), although the movement in the reserves only constitutes a purely technical entry not representing any appropriation of the result disclosed for the last financial year (year N).

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<sup>11</sup> The treatment to be applied to the cash contributions under the future National Resolution Fund and under the Single Bank Resolution Fund will be set later by the CSSF.

22. The credit institutions shall apply the provisions of this circular to the FINREP and COREP as from 31 December 2014.

Yours faithfully,

COMMISSION de SURVEILLANCE du SECTEUR FINANCIER

Claude SIMON  
Director

Andrée BILLON  
Director

Simone DELCOURT  
Director

Jean GUILL  
Director General