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Final Report on Public Consultation No. 14/036 on Guidelines on the loss-absorbing capacity of technical provisions and deferred taxes

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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.

According to Articles 103(c) and 108 of Directive 2009/138/EC[1] (Solvency II Directive) as well as to Articles 205 to 207 of the Implementing Measures[2], undertakings shall calculate an adjustment for the loss-absorbing capacity of technical provisions and deferred taxes. As previous impact studies have shown, the matter is regarded as highly complex and the adjustment has in some cases a large impact on the capital requirement. EIOPA chose therefore to address the topic in guidelines.

As a result of the above, on 2 June 2014 EIOPA launched a Public Consultation on the draft guidelines on the loss-absorbing capacity of technical provisions and deferred taxes. The Consultation Paper is also published on EIOPA's website[3].

These guidelines were issued to undertakings and NCAs to:

- Establish consistent, efficient and effective supervisory practices;
- Ensure the common, uniform and consistent application of Union law on the calculation of the adjustments for the loss-absorbing capacity of technical provisions and deferred taxes to the solvency capital requirement.

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 on EIOPA's website[4].

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[1] OJ L 335, 17.12.2009, p. 1–155

[2] 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

[3] [4] 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 Insurance and Reinsurance Stakeholder Group (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

1. Guideline 9

It was suggested that the approach for recognizing benefits in exchange for transferred losses in tax groups should be more flexible.

EIOPA is however of the view that only legally enforceable benefits should be used to reduce the capital requirement.

Furthermore, one stakeholder suggested extending the scope of the Guideline to "fiscal unities". This type of tax groups does not require a transfer of profits or losses.

EIOPA agrees that in the calculation of the loss-absorbing capacity of deferred taxes it is mainly relevant whether the loss will have an impact on deferred taxes. This may not necessarily require a transfer of profits or losses (depending on the tax regime). The Guideline has therefore been amended to take into account the possible existence of a fiscal unity.

Some stakeholders remarked that it will be difficult to assess whether a counterparty (the "receiving undertaking") will be able to meet its obligation to provide benefits in exchange for transferred losses.

EIOPA would like to emphasise that the chosen approach is consistent with the risk-based approach of Solvency II. Similar approaches are pursuit e.g. for risk-mitigation techniques.

Some stakeholders requested that the receiving undertaking should be able to take into account the one in 200 stress of the transferring undertaking.

EIOPA would like to highlight that allowing the recognition of the one in 200 years stress for the transferring undertaking in the calculation of the loss-absorbing capacity of deferred taxes for the receiving undertaking would be equivalent to the assumption that the one in 200 years stresses for both undertakings occur at the same time. This would be inconsistent with the diversification assumption between solo-undertakings in the group calculation. The approach proposed by stakeholders is therefore not viable.

2. Use of average tax rates

Concerns were voiced that the Guidelines put too many restrictions on the use of average tax rates. One stakeholder was of the opinion that the Guidelines would force undertakings to always calculate a stressed Solvency II balance sheet.

EIOPA would like to emphasise that the Guidelines do not stop undertakings to use an approach based on average tax rates in their calculations. But the calculation has to be performed at a level that ensures the resulting adjustment reflects the actual loss absorbing capacity of deferred taxes.

3. Level of granularity for assumptions on future management actions

It was suggested that in Guideline 5 the level of granularity for assumptions on future management actions should be sufficient to reflect only material and relevant restrictions.

EIOPA agrees and has changed the Guideline accordingly.

4. References to the valuation of deferred taxes

Guideline 10 was based on the assumption that undertakings would always have to apply the principles of IAS12.

EIOPA decided to delete them as - following recent developments - alternative methods might be available.

5. Recognition based on future profits

It was argued that there should be no need for (sophisticated) projections of future profits in case they are used to support notional tax assets.

EIOPA agrees that there should be no general requirement to produce projections. Depending on the specific case a projection might be needed but in principle the method used for the assessment has simply to be fit for purpose. The wording of the Guideline was changed accordingly.

The suggestion was made that the Guidelines should introduce simplifications for the assessment of future profits and there should be more focus on proportionality.

EIOPA does not think the Guidelines are overly prescriptive in terms of the assessment. But some guidance seems warranted given the potentially significant impact of the loss–absorbing capacity of deferred taxes on the overall Solvency Capital Requirement.

6. Loss-absorbing capacity at group level

When calculating the net basic SCR at group level for the purpose of the loss-absorbing capacity of technical provisions, stakeholders pointed out that partial internal model should be taken into account within the formula. Guideline 18 was amended in order to clarify the application for partial internal model users: the value of net basic SCR can be derived either with the aggregation matrices of the standard formula or with the approved internal model.

Some stakeholders, additionally, commented that the calculation approach for the loss-absorbing capacity of technical provision described in Guideline 22 (alternative approach) should replace Guideline 18 as the default approach. EIOPA considers the approach in Guideline 22 as a calculation that can be applied only when there is a reasonable homogeneity in the future discretionary benefits then, it should be kept as an alternative calculation to the one described in Guideline 18.

Guideline 23 proposes a formula to calculate the adjustment for the loss-absorbing capacity of deferred taxes at group level. Some stakeholders found the formula useful, but argued that it should be only used as a simplification and that more complex adjustments should be allowed to take into account the specifics of group taxation existing in some fiscal regimes (such as the impact of "fiscal unity"). EIOPA considers this formula to be an adequate trade-off between simplicity and appropriateness that allows taking into account indirectly the impact of group taxations if taken into account at individual level according to Guideline 9. Although it is true that some complex adjustment cannot be taken into account with this formula, there is still the possibility to develop a more appropriate method via partial internal model.

General nature of the participants to the Public Consultation

EIOPA received six responses from other stakeholders to the public consultation. All the comments received have been published on EIOPA's website.

Respondents can be classified into two main categories: European trade, insurance, or actuarial associations; and national insurance or actuarial associations.

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[5].

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.

[5] https://eiopa.europa.eu/about-eiopa/organisation/stakeholder-groups/sgs-opinion-feedback/index.html

Annex: Guidelines

1. Guidelines on loss-absorbing capacity of technical provisions and deferred taxes

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 ("EIOPA Regulation")[6] EIOPA has drafted Guidelines on the loss-absorbing capacity of technical provisions and deferred taxes.

1.2. The Guidelines relate to Articles 103(c) and 108 of Directive 2009/138/EU 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 (Solvency II)[7] as well as to Article 83 and Articles 205 to 207 of the Implementing Measures.

1.3. These Guidelines are addressed to supervisory authorities under Solvency II.

1.4. The following Guidelines are intended to establish consistent, efficient and effective supervisory practices and to ensure the common, uniform and consistent application of Union law on the calculation of the adjustments for the loss-absorbing capacity of technical provisions and deferred taxes to the Solvency Capital Requirement.

1.5. Guidelines 1 to 14 apply, on a solo basis, to insurance and reinsurance undertakings using the standard formula and where relevant, also to groups using the standard formula.

1.6. Guidelines 15 to 22 apply to groups using the standard formula and when method 1 is used, either exclusively or in combination with method 2. When method 2 is used exclusively, Guidelines 15 to 22 do not apply since the adjustment for the loss-absorbing capacity of technical provisions and deferred taxes is not done additionally at group level. When the combination of methods is used, the Guidelines apply only to the consolidated part of the group.

1.7. The Guidelines do not cover the valuation of technical provisions or deferred tax assets and liabilities in the Solvency II balance sheet, as these are covered by Article 15 of the Implementing Measures.

1.8. The term "deferred taxes" is used in Solvency II in two contexts: firstly to describe items on the Solvency II balance sheet and secondly, in connection with the calculation of tax adjustments to the Solvency Capital Requirement. In order to avoid confusion, the following Guidelines introduce the term "notional deferred taxes" for items used in the calculation of the adjustment.

1.9. For the purpose of these Guidelines, the following definition has been developed:

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[6] OJ L 331, 15.12.2010, p. 48–83
[7] OJ L 335, 17.12.2009, p. 1-155

- ‘Notional deferred taxes’ refers to the sum of the products of all relevant and material tax rates and all relevant and material changes in temporary differences between Solvency II valuation and the valuation for tax purposes resulting from the instantaneous loss referred to in Article 207(1) of the Implementing Measures. In the simplest case, where there is only one tax rate and all losses contribute to a change of temporary differences, the notional deferred taxes would be represented by the product of a uniform tax rate and the loss referred to in Article 207(1) of the Implementing Measures. "Notional deferred taxes" do not represent the difference between pre- and post-stress deferred taxes[8]. An undertaking should assess which amount of the notional deferred taxes could be recognized in the Solvency II balance sheet after suffering the loss in the stress.

1.10. If not defined in these Guidelines, the terms have the meaning defined in the legal acts referred to in the introduction.

1.11. The Guidelines shall apply from 1 January 2016.

Section I: Adjustment for the loss-absorbing capacity of technical provisions

Guideline 1 - Calculation of the Basic Solvency Capital Requirement

1.12. When calculating the impact of a scenario on the basic own funds as referred to in Article 83 of the Implementing Measures undertakings should:

(a) keep the cash flows relating to future discretionary benefits unchanged and not rediscount them; and

(b) where the scenario affects the risk free interest rate term structure, especially the stress on the interest rate level, rediscount only the cash flows relating to guaranteed benefits.

1.13. Undertakings should allow for the requirements set out in paragraph 1.12 when formulating future management actions as referred to in Article 83(2)(a) of the Implementing Measures.

Guideline 2 – Method for determining the capital requirement of sub-modules in the calculation of the Basic Solvency Capital Requirement

1.14. Without prejudice to Guideline 1, where the calculation of a module or sub-module of the Basic Solvency Capital Requirement is based on the impact of a scenario supervisory authorities should allow undertakings to determine its capital requirement based on the respective capital requirement derived for calculating the net Basic Solvency Capital Requirement in the following way:

[8] An example for the concept of notional deferred taxes can be found in an Appendix to the Explanatory Text

(a) calculate the value of future discretionary benefits taking into account the impact of the scenario;

(b) calculate the difference between the value of future discretionary benefits in the current Solvency II balance sheet and the value referred to in a);

(c) add the difference in b) to the capital requirement for the module or sub-module derived for calculating the net Basic Solvency Capital Requirement.

Guideline 3 – Stress impact on future discretionary benefits in the net calculation

1.15. When determining the impact of a scenario on future discretionary benefits included in technical provisions referred to in Article 206(2)(b) of the Implementing Measures undertakings should take into account:

(a) the impact of the scenario on future profits; and

(b) the future management actions regarding the distribution of future discretionary benefits in response to the scenario.

1.16. When calculating the net Basic Solvency Capital Requirement, undertakings should allow for any stresses to the interest rate level, including any changes to the relevant risk free interest term structure used for discounting cash flows relating to future discretionary benefits.

Guideline 4 - Future bonus rates

1.17. Where the assumptions on future management actions following a scenario referred to in Article 206(2)(b) of the Implementing Measures include the variation of future bonus rates, undertakings should allow in the extent of the variation for the nature and the scale of the underlying stress.

Guideline 5 - Management actions

1.18. Undertakings should make assumptions on future management actions regarding the distribution of future discretionary benefits that are consistent with their current business practice.

1.19. In the calculation of the adjustment for the loss-absorbing capacity of technical provisions undertakings should make assumptions on future management actions at a level of granularity that reflects all material and relevant legal, regulatory or contractual restrictions on the distribution of future discretionary benefits.

Section II: Adjustment for the loss-absorbing capacity of deferred taxes - calculation

Guideline 6 - Granularity of calculation

1.20. Undertakings should perform the calculation of the adjustment for the loss-absorbing capacity of deferred taxes at a level of granularity that reflects all material and relevant regulations in all applicable tax regimes.

Guideline 7 – Valuation principles and approaches

1.21. Undertakings should calculate the adjustment for the loss-absorbing capacity of deferred taxes by stressing the Solvency II balance sheet and determining the consequences on the tax figures of the undertaking. The adjustment should then be calculated on the basis of temporary differences between the stressed Solvency II values and the corresponding figures for tax purposes.

1.22. In accordance with the requirements of Article 15(1) of the Implementing Measures, undertakings should take into account all assets and liabilities that are recognized for solvency or tax purposes in the calculation of the loss-absorbing capacity of deferred taxes.

1.23. Notwithstanding paragraph 1.22, supervisory authorities should allow undertakings, when determining the tax consequences of the loss referred to in Article 207(1) of the Implementing Measures, to use an approach based on average tax rates, provided they are able to demonstrate that those average tax rates are determined at an appropriate level, and that such an approach avoids a material misstatement of the adjustment.

Guideline 8 - Loss attribution

1.24. Where undertakings use an approach based on average tax rates, they should allocate the loss referred to in Article 207(1) of the Implementing Measures to its causes in accordance with Article 207(5) of the Implementing Measures if the calculation of the deferred tax adjustment on an aggregate level does not reflect all material and relevant regulations of applicable tax regimes.

1.25. Where the allocation set out in paragraph 1.24 does not reflect all material and relevant regulations of applicable tax regimes, undertakings should allocate the loss to balance sheet items with a sufficient level of granularity to meet this requirement.

Guideline 9 - Arrangements for the transfer of profits or losses

1.26. Where an undertaking has entered into contractual agreements regarding the transfer of profit or loss to another undertaking or is bound by other arrangements under existing tax legislation in the member state (tax groups) or an arrangement whereby such transfer occurs or is considered to occur through an offset of such losses against profits of another undertaking under the applicable tax consolidation rules in the Member State (fiscal unity), the undertaking should take these agreements or arrangements into account in the calculation of the adjustment for loss-absorbing capacity of deferred taxes.

1.27. Where it is contractually agreed and probable that a loss will be transferred to a another undertaking or where such loss transfer occurs or is considered to occur through an offset of such losses against profits of another undertaking ("receiving undertaking") after the undertaking ("transferring undertaking") suffers the instantaneous loss referred to in Article 207(1) of the Implementing Measures, the transferring undertaking should only recognize the related deferred tax adjustment to the extent that the payment or other benefit will be received in exchange for the transfer of notional tax losses.

1.28. The transferring undertaking should only recognize the payment or benefit receivable to the extent that a deferred tax adjustment could be recognized under Guideline 10 if the loss was not transferred.

1.29. The transferring undertaking should only recognize payment or benefits receivable if the arrangement or contractual agreement is legally effective and enforceable by the transferring undertaking with respect to the transfer of those items.

1.30. If the value of payment or benefit receivable is conditional on the solvency or tax position of the receiving undertaking or that of the existing tax consolidation (fiscal unity) as a whole, the transferring undertaking should base the valuation of the payment or benefits receivable on a reliable estimate of the value that is expected to be received in exchange for loss transferred.

1.31. The transferring undertaking should verify that the receiving undertaking is able to honor its obligations in stressed circumstances, namely after suffering the Solvency Capital Requirement stress if the receiving undertaking is subject to Solvency II.

1.32. The transferring undertaking should reflect any tax payable on the payment or benefit received in the recognized amount of notional deferred taxes.

1.33. Where the receiving solo undertaking is subject to Solvency II it should not recognize the transferred loss in the calculation of the adjustment for the loss-absorbing capacity of deferred taxes.

Section III: Adjustment for the loss-absorbing capacity of deferred taxes – recognition

Guideline 10 - Temporary nature

1.34. Undertakings should recognize notional deferred tax assets conditional on their temporary nature. The recognition should be based on the extent to which offsetting is permitted according to the relevant tax regimes. This may include offset against past tax liabilities or current or likely future tax liabilities.

Guideline 11 - Avoidance of double counting

1.35. Undertakings should ensure that deferred tax assets arising from the instantaneous loss defined in Article 207(1) of the Implementing Measures are not supported by the same deferred tax liabilities or future taxable profits already supporting the recognition of deferred tax assets for valuation purposes in the Solvency II balance sheet in accordance with Article 75 of Solvency II.

1.36. Undertakings should follow in their recognition of notional deferred tax assets in a stressed Solvency II balance sheet the principles set out in Article 15 of the Implementing Measures.

Guideline 12 - Recognition based on future profits

1.37. If the recognition of notional deferred tax assets is supported by an assessment of future taxable profit, undertakings should recognize notional deferred tax assets to the extent it is probable that they will have sufficient future taxable profit available after suffering the instantaneous loss.

1.38. Undertakings should employ appropriate techniques to assess the temporary nature of the notional deferred tax assets and the timing of future taxable profits which meet the following requirements:

(a) The assessment is in accordance with Article 15(3) of the Implementing Measures;

(b) The assessment takes into account the prospects of the undertaking after suffering the instantaneous loss.

Guideline 13 - Relief where demonstration of eligibility is burdensome

1.39. Supervisory authorities should allow undertakings to disregard notional deferred tax assets in the calculation of the adjustment for loss-absorbing capacity where it would be too burdensome for the undertaking to demonstrate their eligibility.

Guideline 14 – Notional deferred tax liabilities

1.40. Without prejudice to Article 207(4) of the Implementing Measures undertakings should include notional deferred tax liabilities resulting from the instantaneous loss defined in Article 207(1) of the Implementing Measures in the calculation of the adjustment for the loss-absorbing capacity of deferred taxes.

Section IV: Adjustment for the loss-absorbing capacity of technical provisions and deferred taxes at group level – General provisions

Guideline 15 - Scope

1.41. The participating insurance and reinsurance undertaking, insurance holding company or mixed financial holding company should only apply the adjustment for the loss-absorbing capacity of technical provisions and deferred taxes, when method 1 or the combination of methods is used, to the part of the consolidated data determined in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures.

Section V: Adjustment for the loss-absorbing capacity of technical provisions on group level

Guideline 16 - Scenarios

1.42. Where the standard formula requires the choice between alternative scenarios, the selection should be undertaken at group level. In order to derive the loss-absorbing capacity of technical provisions in the sub-modules of the group calculation, the scenario relevant for the group should be calculated for each insurance and reinsurance undertaking that is consolidated in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures, on the basis of the application of the formula in Guideline 17.

Guideline 17 - Calculation of net basic Solvency Capital Requirement

1.43. When determining the group loss-absorbing capacity of technical provisions at sub-module level, the participating insurance and reinsurance undertaking, insurance holding company or mixed financial holding company should derive the group's net calculation of the Solvency Capital Requirement on sub-modular level based on the following formula, considering the loss-absorbency of technical provisions of each insurance and reinsurance undertaking that is consolidated in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures, recalculated on the basis of the relevant scenario where relevant:

$$netSCR_{sub-\text{module}}^{group} = grossSCR_{sub-\text{module}}^{group} +$$

$$-\sum_{solo} \alpha^{solo} \left(grossSCR_{sub-\text{module}}^{solo} - netSCR_{sub-\text{module}}^{solo} \right) \bullet \min(1; \frac{FDB^{solo}}{grossSCR^{solo} - netSCR^{solo}})$$

Where:

- α^{solo} represents the percentage used for the establishment of the consolidated accounts;

- FDB^{solo} represents the total amount of FDB at the individual level adjusted for intra group transaction, if necessary, according to Article 339(2) of the Implementing Measures;

- $netSCR_{sub-\text{module}}^{solo}$ and $grossSCR_{sub-\text{module}}^{solo}$ should be determined in accordance with Guideline 16;

- $grossSCR^{solo}$ and $netSCR^{solo}$ represent the aggregated $netSCR_{sub-\text{module}}^{solo}$ and $grossSCR_{sub-\text{module}}^{solo}$ for each insurance and reinsurance undertaking, using either the relevant standard formula's correlation matrices or the approved internal model.

1.44. The value of nBSCR in Article 206(1) of the Implementing Measures should be derived with either the aggregation matrices of the standard formula or the approved internal model. The value of future discretionary benefits in Article 206(1) of the Implementing Measures should correspond to the part of future discretionary benefits that relates to the part of consolidated data determined in accordance with Article 335(1) (a),(b) and (c) of the Implementing Measures.

Guideline 18 – Intragroup Transactions

1.45. When preparing the consolidated data, if the part of the best estimate for technical provisions related to future discretionary benefits of the individual insurance and reinsurance undertakings is adjusted for intra-group transactions, in line with Article 339(2) of the Implementing Measures, the total amount of future discretionary benefits at group level should be adjusted accordingly.

Guideline 19 - Upper limit

1.46. The adjustment for loss-absorbency of technical provisions at group level should not exceed the sum of the adjustments for loss absorbency of technical provisions of the insurance and reinsurance undertakings consolidated in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures.

Guideline 20 - Alternative Calculation

1.47. Alternatively to the calculation proposed in Guideline 17, when there is a reasonable level of homogeneity among future discretionary benefits of the participating insurance and reinsurance undertaking and insurance and reinsurance undertakings that are consolidated in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures within the group, the participating insurance and reinsurance undertaking, insurance holding company or mixed financial holding company should calculate the Loss-Absorbing Capacity of technical provisions at group level according to Guideline 21.

1.48. The participating insurance and reinsurance undertaking or insurance holding company should be able to prove to the group supervisor that, according to the group business and risk profile, a reasonable level of homogeneity among future discretionary benefits within the group is ensured.

Guideline 21 - Alternative Calculation

1.49. In accordance with Guideline 20, the participating insurance and reinsurance undertaking, insurance holding company or mixed financial holding company should calculate the adjustment for the loss-absorbing capacity of technical provisions using the following formula:

Where: $Adj_{TP}^{group} = \frac{SCR^{diversified^*}}{\sum_{solo} \propto^{solo} SCR^{solo^*}} \times \sum_{solo} \propto^{solo} Adj_{TP}^{solo}$

- Adj_{TP}^{solo} is the adjustment for the loss-absorbing capacity of technical provisions of each insurance and reinsurance undertaking consolidated in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures;

- $\propto^{solo}$ represents the percentage used for the establishment of the consolidated accounts;

- the ratio $\frac{SCR^{diversified^*}}{\sum_{solo} \propto^{solo} SCR^{solo^*}}$ represents the proportional adjustment due to the diversification effects at group level and, in particular, at the numerator $SCR^{diversified^*}$ [9] is the Solvency Capital Requirement calculated on the basis of the consolidated data in accordance to Article 336(a) of the Implementing Measures but before the adjustment for the loss-absorbing capacity of technical provisions and deferred taxes; and the denominator SCR^{solo^*} is the Solvency Capital Requirement before the adjustment for the loss-absorbing capacity of technical provisions and deferred taxes of each insurance and reinsurance undertaking consolidated in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures.

Section VI: Adjustment for the loss-absorbing capacity of deferred taxes at group level

Guideline 22 - Calculation

1.50. The participating insurance and reinsurance undertaking, insurance holding company or mixed financial holding company should calculate the adjustment for the loss-absorbing capacity of deferred taxes according to the following formula:

Where: $Adj_{DT}^{group} = \frac{SCR^{diversified^{**}}}{\sum_{solo} \propto^{solo} SCR^{solo^{**}}} \times \sum_{solo} \propto^{solo} Adj_{DT}^{solo}$

- $\propto^{solo}$ represents the percentage used for the establishment of the consolidated accounts;
- Adj_{DT}^{solo} is the solo adjustment for the loss-absorbing effect of deferred taxes of each (re)insurance undertaking consolidated in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures;
- $SCR^{solo^{**}}$ is the solvency capital requirement after the LAC adjustment for technical provisions and before the LAC adjustment for deferred taxes of

[9] $SCR^{diversified^*}$ is equal to the following sum, in the case of application of the standard formula: $SCR^{diversified^*} = BSCR^{diversified} + SCR_{operational}^{diversified}$

each insurance and reinsurance undertaking consolidated in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures; and

- $SCR^{diversified^{**}}$[10] is the solvency capital requirement calculated on the basis of the consolidated data in accordance with Article 336(a) of the Implementing Measures after the LAC adjustment for technical provisions and before the LAC adjustment for deferred taxes.

Compliance and Reporting Rules

1.51. This document contains Guidelines issued under Article 16 of the EIOPA Regulation. In accordance with Article 16(3) of the EIOPA Regulation, national competent authorities shall make every effort to comply with guidelines and recommendations.

1.52. Competent authorities that comply or intend to comply with these Guidelines should incorporate them into their regulatory or supervisory framework in an appropriate manner.

1.53. 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.

1.54. 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

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

[10] $SCR^{diversified^{**}}$ is equal to the following sum, in the case of application of the standard formula: $SCR^{diversified^{**}} = BSCR^{diversified} + SCR^{diversified}_{operational} + Adj^{group}_{TP}$

2. Explanatory text

Guideline 8 - Loss attribution

Where undertakings use an approach based on average tax rates, they should allocate the loss referred to in Article 207(1) of the Implementing Measures to its causes in accordance with Article 207(5) of the Implementing Measures if the calculation of the deferred tax adjustment on an aggregate level does not reflect all material and relevant regulations of applicable tax regimes.

Where the allocation set out in paragraph 1.24 does not reflect all material and relevant regulations of applicable tax regimes, undertakings should allocate the loss to balance sheet items with a sufficient level of granularity to meet this requirement.

2.1. An example for loss attribution to sub-modules can be found in section 3.2. of the Appendix. Section 3.3 gives an example for a method that could be employed for re-distributing the loss to sub-modules, appropriately taking into account a diversification adjustment.

Guideline 9 - Arrangements for the transfer of profits or losses

Where an undertaking has entered into contractual agreements regarding the transfer of profit or loss to another undertaking or is bound by other arrangements under existing tax legislation in the member state (tax groups) or an arrangement whereby such transfer occurs or is considered to occur through an offset of such losses against profits of another undertaking under the applicable tax consolidation rules in the Member State (fiscal unity), the undertaking should take these agreements or arrangements into account in the calculation of the adjustment for loss-absorbing capacity of deferred taxes.

Where it is contractually agreed and probable that a loss will be transferred to a another undertaking or where such loss transfer occurs or is considered to occur through an offset of such losses against profits of another undertaking ("receiving undertaking") after the undertaking ("transferring undertaking") suffers the instantaneous loss referred to in Article 207(1) of the Implementing Measures, the transferring undertaking should only recognize the related deferred tax adjustment to the extent that the payment or other benefit will be received in exchange for the transfer of notional tax losses.

The transferring undertaking should only recognize the payment or benefit receivable to the extent that a deferred tax adjustment could be recognized under Guideline 10 if the loss was not transferred.

The transferring undertaking should only recognize payment or benefits receivable if the arrangement or contractual agreement is legally effective and enforceable by the transferring undertaking with respect to the transfer of those items.

If the value of payment or benefit receivable is conditional on the solvency or tax position of the receiving undertaking or that of the existing tax consolidation (fiscal unity) as a whole, the transferring undertaking should base the valuation of the payment or benefits receivable on a reliable estimate of the value that is expected to be received in exchange for loss transferred.

The transferring undertaking should verify that the receiving undertaking is able to honor its obligations in stressed circumstances, namely after suffering the Solvency Capital Requirement stress if the receiving undertaking is subject to Solvency II.

The transferring undertaking should reflect any tax payable on the payment or benefit received in the recognized amount of notional deferred taxes.

Where the receiving solo undertaking is subject to Solvency II it should not recognize the transferred loss in the calculation of the adjustment for the loss-absorbing capacity of deferred taxes.

2.2. Agreements or arrangements for the transfer of taxable losses to another group company for payment or benefit receivable is not be considered as an alternative means by which undertakings can justify the utilisation of the loss-absorbing capacity (LAC) of deferred taxes (DT). If undertakings cannot provide evidence that it is likely they will have current tax liabilities or future profits against which they could utilise the tax losses then they do not have to recognise any LAC of DT in the Solvency Capital Requirement calculation, notwithstanding that they may receive payment for transfer of the tax loss to a group company.

2.3. Where undertakings can prove evidence of current tax liabilities or likely future taxable profits against which they could utilise the tax loss, but are bound by agreements or arrangements on the transfer of tax losses or, in the absence of a formal agreement or arrangement, choose instead to transfer the loss to another group company for less value than they would obtain by using it themselves, then they only have to recognise the lower amount in their Solvency Capital Requirement calculation.

Guideline 11 - Avoidance of double counting

Undertakings should follow in their recognition of notional deferred tax assets in a stressed Solvency II balance sheet the principles set out in Article 15 of the Implementing Measures.

2.4. To avoid double counting, future taxable profits that are already used to demonstrate likely utilisation and thus recognition of deferred tax assets on the Solvency II balance sheet are deducted from the post-stress future taxable profits. Only the remaining amount may be used to demonstrate likely utilisation and thus recognition of the notional deferred tax asset. This is especially relevant where an approach based on average tax rates is used.

Guideline 15 – Scope

The participating insurance and reinsurance undertaking, insurance holding company or mixed financial holding company should only apply the adjustment for the loss-absorbing capacity of technical provisions and deferred taxes, when method 1 or the combination of methods is used, to the part of the consolidated data determined in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures.

2.5. The LAC adjustment of TP and DT is applied at group level only when method 1 is used, exclusively or in combination with method 2, only to the part of the consolidated data determined in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures.

2.6. If the participating insurance and reinsurance undertaking, insurance holding company or mixed financial holding company method 2, the calculation of the adjustment is not done at group level, since the group SCR is computed as the aggregation of individual SCR's that have already been adjusted for loss-absorbing capacity of technical provisions and deferred taxes at individual level where relevant.

Guideline 16 – Scenarios

Where the standard formula requires the choice between alternative scenarios, the selection should be undertaken at group level. In order to derive the loss-absorbing capacity of technical provisions in the sub-modules of the group calculation, the scenario relevant for the group should be calculated for each insurance and reinsurance undertaking that is consolidated in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures, on the basis of the application of the formula in Guideline 17.

2.7. Certain sub-modules require the adoption of the most severe of alternative scenarios (i.e. interest rate, currency, lapse, health disability-morbidity). Since the relevant scenarios may differ between individual undertakings and the group, this may imply that individual undertakings need to provide the participating (re)insurance undertaking, insurance holding company or mixed financial holding company with alternative calculations on sub-module level. The selection of the relevant scenario at group level follows the same principle as at individual level, i.e. the relevant scenario at group level has to be the one for which the net solvency capital requirement at sub-modular level is the highest. The details of the approach to be followed for the selection of the relevant scenario at group level are provided in step e) of the explanatory text under the following Guideline 17.

Guideline 17 - Calculation of net basic SCR

When determining the group loss-absorbing capacity of technical provisions at sub-module level, the participating insurance and reinsurance undertaking, insurance holding company or mixed financial holding company should derive the group's net calculation of the Solvency Capital Requirement on sub-modular level based on the following formula, considering the loss-absorbency of technical provisions of each insurance and reinsurance undertaking that is consolidated in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures, recalculated on the basis of the relevant scenario where relevant:

$$netSCR_{sub-\text{module}}^{group} = grossSCR_{sub-\text{module}}^{group} +$$

$$-\sum_{solo} \alpha^{solo}\left(grossSCR_{sub-\text{module}}^{solo} - netSCR_{sub-\text{module}}^{solo}\right) \bullet \min(1; \frac{FDB^{solo}}{grossSCR^{solo} - netSCR^{solo}})$$

Where:

- α^{solo} represents the percentage used for the establishment of the consolidated accounts;
- FDB^{solo} represents the total amount of FDB at the individual level adjusted for intra group transaction, if necessary, according to Article 339(2) of the Implementing Measures;
- $netSCR_{sub-\text{module}}^{solo}$ and $grossSCR_{sub-\text{module}}^{solo}$ should be determined in accordance with Guideline 16;
- $grossSCR^{solo}$ and $netSCR^{solo}$ represent the aggregated $netSCR_{sub-\text{module}}^{solo}$ and $grossSCR_{sub-\text{module}}^{solo}$ for each insurance and reinsurance undertaking, using either the relevant standard formula's correlation matrices or the approved internal model.

The value of nBSCR in Article 206(1) of theImplementing Measures should be derived with either the aggregation matrices of the standard formula or the approved internal model. The value of Future Discretionary Benefits in Article 206 (1) of the Implementing Measures should correspond to the part of future discretionary benefits that relates to the part of consolidated data determined in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures.

2.8. The calculation of the LAC of TP at group level starts at sub-modular level: the group's net basic SCR referred to in Article 206(1) of the Implementing Measures is obtained on sub-modular level by using the actual loss-absorbency of technical provisions of each individual (re)insurance undertaking (consolidated in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures) eventually recalculated taking into account the relevant scenario at the group level in accordance with Guideline 16. This means that the gross SCR ($grossSCR_{sub-\text{module}}^{solo}$) and net SCR ($netSCR_{sub-\text{module}}^{solo}$) at sub modular level used in the formula are the ones adjusted for the group calculation on the basis of the relevant scenario at group level.

2.9. The calculation of the group LAC of TP derived on sub-modular level follows the following steps:

a) identify the (re) insurance undertakings that are consolidated in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures;

b) for each one of the individual undertaking, identify the proportional share used for the establishment of the consolidated accounts[11] α (usually 100%, unless they are proportionally consolidated);

c) for each one of the individual undertaking, identify the portion of LAC generated by technical provisions that is admitted considering the cap at individual level: FDBi / (grossSCRi - netSCRi)[12], where FDBi is adjusted for IGTs if necessary according to Article 339(2) of the Implementing Measures;

d) for each sub-module, consider the actual LAC of each individual undertaking and multiply with the coefficients calculated in steps (b) and (c) for the related undertakings;

e) for sub-modules which require the application of several scenarios (for instance: up and down for the interest rate risk), the LAC at individual level in the sub-module should be (re)calculated taking into consideration the scenario relevant at group level (see Guideline 16) and step (d) would consist of the following calculations:

    i. calculation of gross SCR solo and net SCR solo at sub-module level for up and down scenarios of each (re)insurance undertakings in the scope;

    ii. calculation of the gross group SCR for all required scenarios (up and down) (=> grossSCR(group, sub-module, up) and grossSCR(group, sub-module, down));

    iii. application of the formula in Guideline 17 for up and down scenarios; this step gives a netSCR(group, sub-module, up) and a netSCR(group, sub-module, down);

    iv. selection of the scenario relevant at group level, depending on the outcome of the previous step;

f) for each sub-module, obtain the group LAC of TP by summing up the results of step (e) across all solo undertakings in the scope;

[11] Taking into account the Guidelines on Group Solvency Calculation (Guideline 9), the percentage used for the inclusion of subsidiaries that are fully consolidated in accordance to Article 335(1)(a) and (b) of the Implementing Measures should be 100%, then α solo should be one.

[12] In step 3 above, if this ratio happens to be higher than 1 then we should apply 1.

g) for each sub-module, obtain the net basic SCR, $netSCR^{group}_{sub-\text{module}}$, as the difference between $grossSCR^{group}_{sub-\text{module}}$ and the sum obtained at step (e) (group LAC of TP at sub-modular level);

h) the adjustment for LAC of TP at group level is then, as indicated in Article 206 of the Implementing Measures, the difference between the basic $SCRgroup$ calculated on the basis of the consolidated data in accordance with Article 336(a) of the Implementing Measures and the $netSCR^{group}$ obtained aggregating the net SCR at step 6 via the relevant correlation or aggregation matrix;

i) the adjustment for LAC of TP at group level is then capped to the amount of FDB at group level net of IGTs according to Guideline 18.

2.10. The limitation of the loss-absorbing effect of future profit participation to the amount of Future Discretionary Benefits (FDB) on the pre-stressed balance sheet is applied to both the loss-absorbing effect at the group level and at the individual level.

2.11. In the cases when the initial LAC of TP adjustment of the individual undertaking (difference between gross and net SCR) calculated according to the solo scenario exceeds the actual solo future discretionary benefits then the recalculation according to the group scenario should be adjusted by the cap (as expressed by function "minimum") to reflect the fact that the initial adjustment amount according to the group scenario at sub-module level has in fact limited possibility to absorb losses to the same extent as at the level of the whole insurance undertaking.

Guideline 20 - Alternative Calculation

Alternatively to the calculation proposed in Guideline 17, when there is a reasonable level of homogeneity among future discretionary benefits of the participating insurance and reinsurance undertaking and insurance and reinsurance undertakings that are consolidated in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures within the group, the participating insurance and reinsurance undertaking, insurance holding company or mixed financial holding company should calculate the Loss-Absorbing Capacity of technical provisions at group level according to Guideline 21.

The participating insurance and reinsurance undertaking or insurance holding company should be able to prove to the group supervisor that, according to the group business and risk profile, a reasonable level of homogeneity among future discretionary benefits within the group is ensured.

2.12. A reasonable level of homogeneity among future discretionary benefits of the participating and controlled (re)insurance entities within the group can be assessed in relation to the type of profit sharing mechanism of the portfolios (i.e. considering the type of financial guarantees) and in relation to the underlying types of assets held by the participating and controlled (re)insurance entities. For the purpose of assessing the level of homogeneity, the geographical localization of the group may be a relevant information (i.e. national or cross border groups).

2.13. In particular, the following criteria would apply:

(a) homogenous SCR risk profile with respect to relative weight of sub-modules and relevant scenarios;

(b) homogenous business portfolios with respect to types of policies, policyholder features, profit sharing mechanisms;

(c) homogenous reinsurance program;

(d) homogenous tax regimes.

2.14. Where the standard formula requires the choice between alternative scenarios, in case of a reasonable level of homogeneity among future discretionary benefits of the participating and controlled insurance and reinsurance undertakings within the group, the relevant scenarios selected at group level mirror on a sufficient level the relevant scenarios selected at individual level.

Guideline 21 - Alternative Calculation

In accordance with Guideline 20, the participating insurance and reinsurance undertaking, insurance holding company or mixed financial holding company should calculate the adjustment for the loss-absorbing capacity of technical provisions using the following formula:

Where: $$Adj_{TP}^{group} = \frac{SCR^{diversified^*}}{\sum_{solo} \propto^{solo} SCR^{solo^*}} \times \sum_{solo} \propto^{solo} Adj_{TP}^{solo}$$

- Adj_{TP}^{solo} is the adjustment for the loss-absorbing capacity of technical provisions of each insurance and reinsurance undertaking consolidated in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures;

- $\propto^{solo}$ represents the percentage used for the establishment of the consolidated accounts;

- the ratio $\frac{SCR^{diversified^*}}{\sum_{solo} \propto^{solo} SCR^{solo^*}}$ represents the proportional adjustment due to the diversification effects at group level and, in particular, at the numerator $SCR^{diversified^*}$ [13] is the Solvency Capital Requirement calculated on the basis of the consolidated data in accordance to Article 336(a) of the Implementing Measures but before the adjustment for the loss-absorbing capacity of technical provisions and deferred taxes; and the denominator SCR^{solo^*}

[13] $SCR^{diversified^*}$ is equal to the following sum, in the case of application of the standard formula: $SCR^{diversified^*} = BSCR^{diversified} + SCR_{operational}^{diversified}$

is the Solvency Capital Requirement before the adjustment for the loss-absorbing capacity of technical provisions and deferred taxes of each insurance and reinsurance undertaking consolidated in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures.

2.15. Under this alternative procedure, the adjustment for the LAC of TP at group level is calculated as an adjusted sum of the individual adjustments for the LAC of TP, where the individual LAC adjustments are proportionally reduced due, on the one hand, to the recognition of diversification effects at group level given that the SCR of the group is less than the sum of the individual solvency requirements and, on the other hand, to the percentage ($\propto^{solo}$) used for the establishment of the consolidated accounts.

2.16. The adjustment for the LAC of TP calculated as suggested above ensures that the limitation of the loss absorbency capacity of TP to the amount of the Future Discretionary Benefits (FDB) is applied to both the loss absorbing effects at the group and at the individual level.

2.17. In fact, the proportional reduction of the contribution of each individual LAC of TP to the adjusted sum in the formula ensures that the adjustment for loss-absorbency of technical provisions at group level does not exceed the sum of individual adjustments.

Guideline 22 –Calculation

The participating insurance and reinsurance undertaking, insurance holding company or mixed financial holding company should calculate the adjustment for the loss-absorbing capacity of deferred taxes according to the following formula:

$$Adj_{DT}^{group} = \frac{SCR^{diversified^{**}}}{\sum_{solo} \propto^{solo} SCR^{solo^{**}}} \times \sum_{solo} \propto^{solo} Adj_{DT}^{solo}$$

Where:

- $\propto^{solo}$ represents the percentage used for the establishment of the consolidated accounts;

- Adj_{DT}^{solo} is the solo adjustment for the loss-absorbing effect of deferred taxes of each (re)insurance undertaking consolidated in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures;

- $SCR^{solo^{**}}$ is the solvency capital requirement after the LAC adjustment for technical provisions and before the LAC adjustment for deferred taxes of each insurance and reinsurance undertaking consolidated in accordance with Article 335(1)(a),(b) and (c) of the Implementing Measures; and

- $SCR^{diversified^{**}}$[14] is the solvency capital requirement calculated on the basis of the consolidated data in accordance with Article 336 (a) of the Implementing Measures after the LAC adjustment for technical provisions and before the LAC adjustment for deferred taxes.

2.18. The adjustment for the LAC of DT at group level is calculated as an adjusted sum of the individual adjustments for the LAC of DT where the individual LAC adjustments are proportionally reduced due, on the one hand, to the recognition of diversification effects at group level given that the SCR of the group is less than the sum of the individual solvency requirements and, on the other hand, to the percentage ($\propto^{solo}$) used for the establishment of the consolidated accounts[15].

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[14] $SCR^{diversified^{**}}$ is equal to the following sum, in the case of application of the standard formula: $SCR^{diversified^{**}} = BSCR^{diversified} + SCR_{operational}^{diversified} + Adj_{TP}^{group}$

[15] Taking into account the Guidelines on Group Solvency Calculation (Guideline 9), the percentage used for the inclusion of subsidiaries that are fully consolidated in accordance to Article 335(1)(a) and (b) of the Implementing Measures should be 100%, then $\propto^{solo}$ should be one.

Appendix - Examples

Example for a method based on the concept of notional deferred taxes

An undertaking holds only equities and has no liabilities. The Solvency II value of the equities is 100, the tax value is 80 and the tax rate is 25%. Therefore the Solvency II balance sheet looks as follows (DTL denotes the deferred tax liabilities):

Equities = 100	DTL = (100-80)*25% = 5
	BOF = 95

The BSCR has a value of 39, the sole contributor to the risk charge is equity risk, and no other effects (diversification, loss-absorbing capacity of technical provisions) are applicable. In the stressed Solvency II balance the value of the assets excluding any DTA is 61. Since there are no other non-deferred tax balance sheet items, this is all the information we need for the stressed Solvency II balance sheet. After the stress, the difference of the assets to the tax base is -19. In the most extreme case, the undertaking could therefore on the one hand set up DTA of 4.75. The DTL on the other hand disappear from the balance sheet. The most extreme change in the value of deferred taxes is:

$$nDT = 4.75 + 5 = 9.75$$

This amount is called notional deferred taxes (nDT). It is worth to note that it is equal to the loss multiplied by the single tax rate from the example (39*25% = 9.75). We will use that in the simplification below. In a next stage, the undertaking has to verify whether this amount could be recognized after the one in 200 years stress. This requires in consequence an assessment whether the DTA of 4.75 can be utilised against probable future profits after the one in 200 years stress.

Alternatively, the undertaking could use the simplified method presented in this section. The method follows a two-step approach that separates the valuation from the recognition of the adjustment for the loss-absorbing capacity of deferred taxes. Notional deferred taxes are an interim step in this approach representing the valuation of the adjustment. The nDT will be calculated as mentioned above as the product of the loss and the tax rate. This avoids the setting up of a stressed Solvency II balance sheet. In a second step, recognition could follow the procedure below:

a. Check if nDT can be recognised, full or in part, on basis of DTL by considering if the items could be offset by carrying back of the losses against profits in prior years or carrying forward to offset with future profits.

b. Identify the remaining notional deferred taxes.

In the above example, assuming all relevant criteria for offset are met, the remaining notional deferred taxes ($nDTA^r$) is :

$$nDTA^r = nDTA – DTL = 4.75$$

c. Assess whether $nDTA^r$ can be recognised based on probable future profits for the undertaking in a post-stress environment. (According to Guideline 13, undertakings may omit this step where it would be too burdensome.)

If after completing the steps a. to c. the full amount of notional deferred taxes can be recognised, the net SCR would be:

SCR = 39 – 9.75 = 29.25

Assuming that offsetting against current DTL is possible, but it is not probable that future profits will be available for the undertaking in a post-stress environment to offset $nDTA^r$:

SCR = 39 – 5 = 34.

Examples for a method for calculation of notional deferred taxes on a sub-module basis

(a) Example of how the LAC of notional deferred taxes can be calculated in a tax regime which has a uniform tax rate on all profits, and where no item-specific treatment or limits apply in respect of the tax deductibility of losses:

> An undertaking faces a very simple tax regime, where all profits are taxed at 25%, and profits/losses from all types of transaction are considered together. If this undertaking calculated its pre-DT SCR as €1,000,000 then the notional DTA would be:
>
> €1,000,000 x 25% = €250,000

(b) Example of how the LAC of notional deferred taxes can be calculated in a more complex tax regime where:

i. investment profits are taxed at 25% and all other profits are taxed at 35%;

ii. it is not possible to offset losses from one source against profits in others.

> In this case, the undertaking must split the pre-DT SCR between losses that will attract a tax relief of 25% and 35%. It may be reasonable to assume that the losses arising from market risk are those that attract the 25% and all others attract the 35% relief.
>
> Suppose that the undertaking has a total pre-DT SCR of €1,000,000 of which, after appropriate re-distribution of the diversification effect (for an optional method see Annex 3.3), 70% is derived from market risk and 30% from other risk modules. In that case the undertaking would calculate the notional DT as:
>
> (€700,000 x 25%) + (€300,000 x 35%) = €280,000

(c) Example of how the LAC of notional deferred tax can be calculated in a more complex tax regime where:

i. all profits are taxed at 35%, except from investments in certain infrastructure projects, that are exempt from taxation;

ii. it is not possible to offset losses from one source against profits from others.

In this case, the undertaking must split the pre-DT SCR between losses that will attract tax relief of 35% and those that will attract no tax relief.

Suppose that the undertaking has a total pre-DT SCR of €1,000,000 of which 10% is derived from property risk and 90% from other risk modules. 50% of the property exposure is in infrastructure. In that case the undertaking would the calculate notional DT as:

€950,000 x 35% = €332,500

Optional Method for the redistribution of risk charges to standard formula modules

Let *U* be the vector of undiversified net risk charges of the sub-modules within a risk module, and *C* be the corresponding correlation matrix. Then, the diversified risk capital *s* of the module is:

$s = (U^T \times C \times U)^{0.5}$,

and the diversified risk charge r_i of the individual sub-module *i* is:

$r_i = u_i \cdot y_i / s$, wheras $y_i \in Y$, $Y = C \times U$.