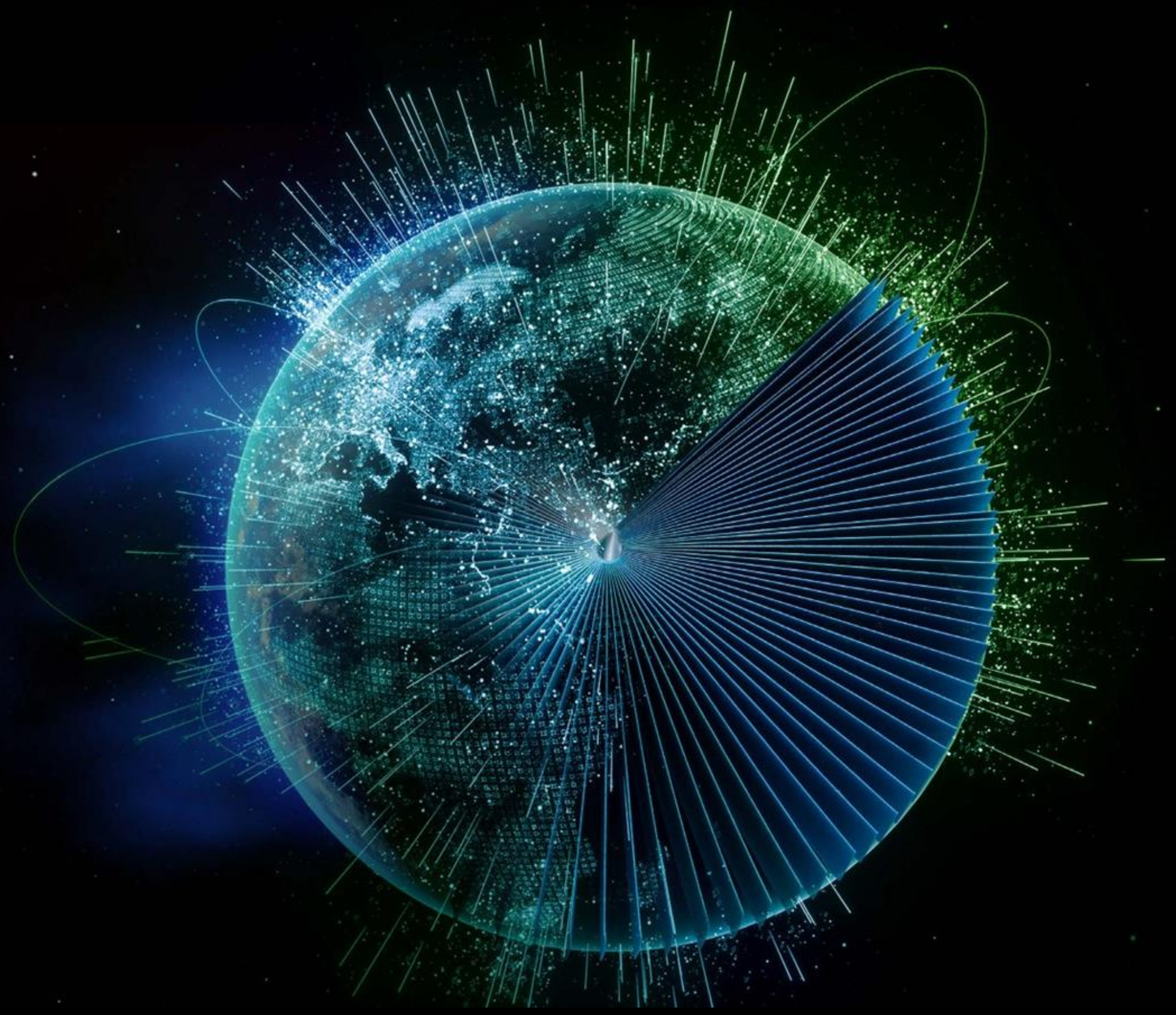


The Danish Compromise

01 Executive Summary

Within the European Union's banking supervision framework (Capital Requirements Regulation or CRR), the Danish Compromise (DC) provides for an exceptional treatment of equity investments in insurance subsidiaries undertaken by banking groups. In a nutshell, the Danish Compromise allows a favorable treatment of insurance holdings in a bank's capital requirements, providing a supportive framework for the establishment and expansion of financial conglomerates.

Under this approach, instead of fully consolidating insurance subsidiaries under banking regulations, banks have two options:

- Use the Standard Treatment, deducting the value of their equity investment in the insurance subsidiary from their regulatory capital.
- Apply the Danish Compromise, which assigns risk-weighted capital charges to the insurance subsidiary.

The Danish Compromise has been object of ongoing consultations between banks and regulatory authorities. Recent interpretations issued by the European Banking Authority (EBA) for instance have paved the way for the potential application of the so-called Danish Compromise Squared (DC^2), i.e. the twofold application of the regulation if an insurance subsidiary of a bank carries out an equity investment. This interpretation could open new M&A opportunities in the EU banking sector, as the recent acquisition of AXA Investment Management carried out by Cardif, the insurance subsidiary of BNP Paribas, which marked the first application of DC^2 in the European Union.

Our analysis examines the scope of this measure, distinguishing its application between financial conglomerates and non-conglomerate financial institutions. It also outlines the conditions institutions must meet to benefit from the measure, as well as the technical adjustments embedded in the deduction methods.

02 Danish Compromise

2.1 Macroeconomic Context and Its Influence on M&A Activity

The current macroeconomic context presents dynamics that could have an impact on M&A activity in banking, insurance and asset and wealth management sectors.

Macroeconomic Environment - Banking

The macroeconomic landscape, shaped by the conclusion of the interest rate hiking cycle, continues to impact M&A activity in the banking sector. Reduced inflationary pressures, combined with less restrictive monetary policies, have contributed to a more stable economic environment, supporting equity market resilience.

The banking sector, in particular, has benefited from higher net interest margins and effective risk management strategies, which sustain equity valuations and increase the appeal of M&A transactions. Against this backdrop, European banks are pursuing acquisitions to diversify risks, optimize revenue streams, and improve structural efficiency. Recent announced transactions, such as UniCredit's investment in Commerzbank's equity and BBVA's acquisition of Banco Sabadell, illustrate efforts to consolidate operations and enhance competitiveness, laying the foundation for stronger and more integrated entities.

The Role of Bancassurance

Bancassurance remains a central component of the distribution model, providing insurers with access to established customer bases through bank branches while offering banks an opportunity to diversify revenue streams and improve operational efficiency.In Italy, the bancassurance sector plays a pivotal role serving as the primary distribution channel for the Life business, which accounted for 52,9% of total GWP in 2023. In the Non-life business, bancassurance has shown steady growth, with penetration rates exceeding 10% by 2023 and gradually approaching levels observed in more mature markets such as France and Spain, where non-life insurance penetration reaches 15–20%. Additionally, volume growth in Italy has outpaced the market average, expanding at approximately 2.5 times the industry rate. While bancassurance already accounts for a significant share of insurance premiums, there remains room for growth, particularly in non-life segments such as health, mortgages, and automotive insurance, where expanded distribution could strengthen market positioning.

Trends in Asset and Wealth Management sector

The asset and wealth management industry continues to face margin pressure despite global growth in 2023. Assets under management (AuM) increased by 12%, reaching nearly $120 trillion, recovering from a 9% decline in 2022. However, this growth highlights a challenging dynamic: revenues grew by only 0.2%, while costs increased by 4.3%, resulting in an 8.1% decline in profits.

In this context, scale has become an important factor for competitiveness, alongside advancements in AI and technology, broad distribution capabilities, and diversified product offerings. These elements are shaping the anticipated trend of consolidation in the asset management industry. M&A activity in this sector is increasingly influenced by the retention and acquisition of key managerial talent and the strengthening of AuM. Banks, already active in asset management, are exploring opportunities to expand critical mass and develop synergies, particularly with life bancassurance operations.
The extension of the Danish Compromise is encouraging financial conglomerates to acquire asset management operators, consolidating their business in managing life bancassurance products. A recent example is Banco BPM's public tender offer for Anima Holding, which demonstrates how such transactions align asset management with insurance activities and improve operational alignment.

2.2 Danish Compromise scope of application- Financial Conglomerates identification

Under **CRD IV** and **CRR** framework (EU directives issued in June 2013 and implemented in Italy via Bank of Italy Circular No. 285/2013), competent authorities may permit institutions to apply risk-weighting to certain undertakings, and insurance holding companies instead of deducting these from capital, in accordance with **Article 49** - whose scope of application is extended for institutions recognized as Financial Conglomerates - and **Article 471,** which regulates deductions for institutions not recognized as Financial Conglomerates that satisfy certain conditions.

What is a financial conglomerate?
Directive 2002/87/CE, specifically **Articles 2 and 3**, outlines the structural and quantitative requirements necessary to identify a financial conglomerate for the purpose of supplementary capital provisions:

Structurally, **Article 2** specifies that a financial conglomerate must have a regulated entity-such as a credit institution, an insurance undertaking, or an investment firm-either at the head of the group or as one of its subsidiaries. If a regulated entity is at the head of the group, it must either act as the parent undertaking of another financial sector entity, hold a participation in such an entity, or be linked to a financial sector entity in a manner that requires the preparation of consolidated financial statements and a management report. Alternatively, if no regulated entity is at the head of the group, the group's activities must primarily occur within the financial sector (e.g., insurance, banking, or investment services), with at least one entity operating in the insurance sector and another in the banking or investment services sector. Furthermore, the activities of entities in both the insurance sector the banking and investment services sector must be deemed significant on a consolidated or aggregated basis. These criteria collectively ensure the proper identification of financial conglomerates subject to enhanced prudential supervision.

Article 3 of Directive 2002/87/CE establish the quantitative requirements for identifying a financial conglomerate. These requirements assess both the size and the significance of a group's financial activities.

- **Size**: A group's activities are considered to mainly occur within the financial sector if the consolidated or aggregated balance sheet total of the entities in the financial sector exceeds 40% of the group's overall consolidated or aggregated balance sheet total.
- **Significance**: Financial sector activities are deemed significant if the average of the following two ratios for each financial sector (e.g., insurance, banking, or investment services) exceeds 10%:

1) $$\frac{\textit{Tot Balance Sheet of a specific financial sector}}{\textit{Tot Balance Sheet of the entities of the Group financial sector}}$$

2) $$\frac{\textit{Tot Solvency requirements of a specific financial}}{\textit{Tot Solvency requirements of the entities of the Group financial sector}}$$

- Alternatively, financial sector activities are considered significant if the balance sheet total of the smallest financial sector in the group exceeds €6 billion.

These thresholds ensure that financial conglomerates with substantial cross-sectoral activities are identified for appropriate regulatory supervision.

Exclusion of Financial Conglomerates from additional supervision
Circumstantially, **Art. 3.3** identifies two relevant criteria by which the coordinator and, where appropriate, the relevant competent authorities decide that a group identified as a financial conglomerate (according to articles above) should not be subject to all requirements of supplementary supervision as required under Directive 2002/87/EC.:

1. If the group does not reach the threshold exposed in paragraph 2 of Article 3, the relevant competent authorities may decide by common agreement not to regard the group as a financial conglomerate (**Art. 3.3**);
2. If the group reaches the threshold exposed in point 2 of Article 3, but the smallest sector does not exceed EUR 6bn, the relevant competent authorities may decide by common agreement not to regard the group as a financial conglomerate (**Art. 3.3a**).

2.3 The two options for the application of the Danish Compromise

Article 49 – Financial Conglomerate

With permanent effect**, Art. 49** allows institutions that satisfy the requirements described in the previous paragraph (i.e., financial conglomerates) to not deduct participation in certain equity holdings in insurance undertakings from capital requirements but apply a risk weighting to them, given that the following requirements are met:

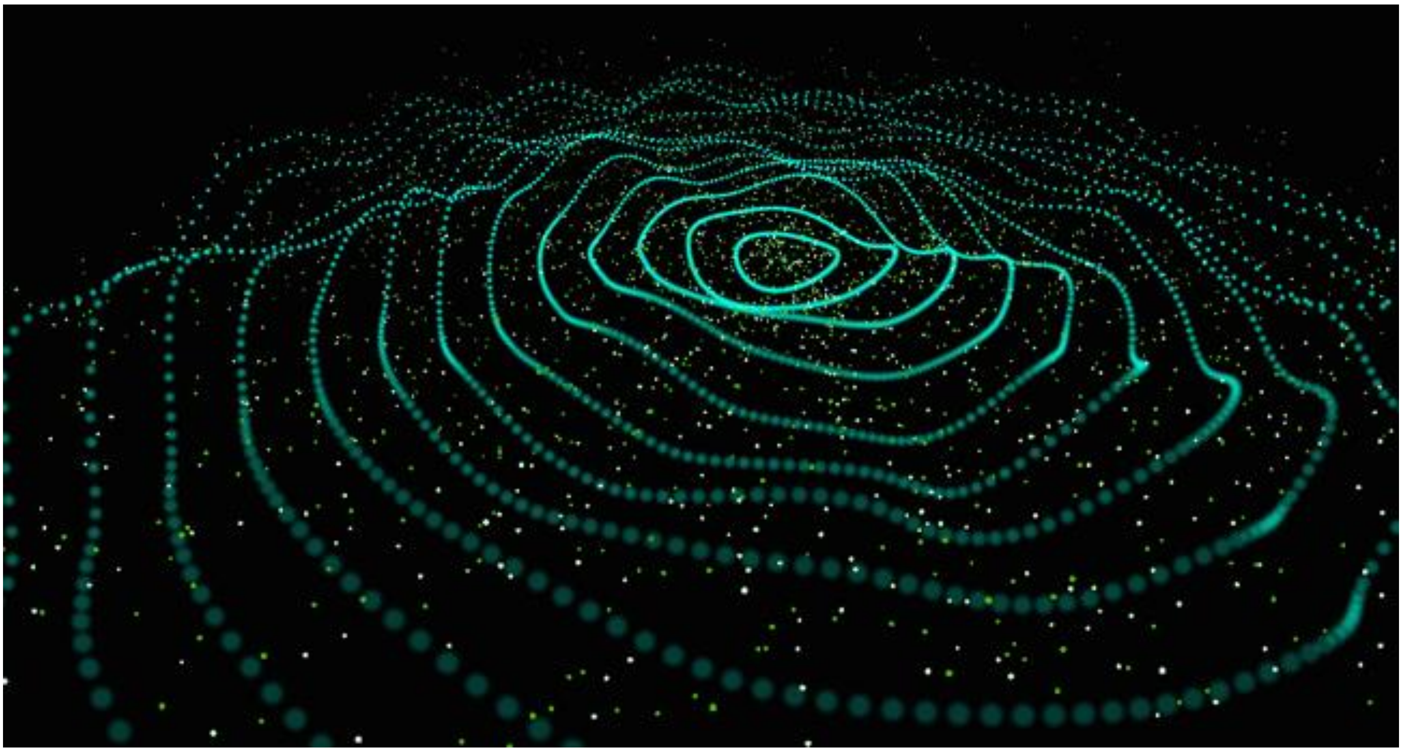
1. Participations must pertain to insurance or reinsurance undertakings, or insurance holding companies included within the scope of the same supplementary supervision framework.
2. Competent authorities grant authorization to not deduct such participations.
3. The participations belong to the parent credit institution, the parent financial holding company, the parent mixed financial holding company, the institution itself, or the subsidiaries of these entities.
4. Competent authorities are required to ensure that the entities within the financial conglomerate maintain continuous adequacy in integrated management, risk management, and internal control systems to uphold the stability and compliance of the conglomerate.

Article 471 – Not Conglomerate Financial Institutions

Deductions for institutions excluded from Art. 49 (i.e., non-conglomerate financial institutions) are regulated by **Art. 471**. The article, according to CRR, had an initial temporary effect (31st Dec 2018-31st Dec 2024), however, Basel IV made the measure permanent.

Under Art. 471 those institutions are allowed to apply risk-weighting to certain equity holdings in insurance undertakings, given that the following conditions are met:

1. Points 1,2, and 3 of Art. 49 represented on the left.
2. Authorities evaluate the adequacy of the risk controls and financial analysis procedures implemented to manage investments in insurance or reinsurance undertakings or insurance holding companies.
3. Participations in these entities must not exceed 15% of Common Equity Tier 1 (CET1) capital issued by the insurance entity as of December 31, 2012, and during the period from January 1, 2013, to December 31, 2024.
4. The total amount of participations that are not deducted must not exceed the CET1 capital as of December 31, 2012.



2.4 Application example of the Danish Compromise

As an illustrative example of how Danish Compromise is applied, let's consider the case of an institution acquiring an insurance investment that is consolidated line by line in the institution's consolidated financial statements. For regulatory consolidation purposes, the investment is valued using the equity method, meaning its book value is equal to the acquisition cost plus changes in equity since the date control was established.

To reflect the increased risk to the institution, institutions are required to make adjustments to capital requirements either according to the Standard Treatment under Article 48 CRR or according to the Danish Compromise. More specifically, we illustrate in summary the different impacts on Own Funds and Capital Requirements according to each method[1]:

Figure 1: Different methods to account for additional capital requirements[2]

	Standard treatment (ex art. 48 CRR)	Danish Compromise: Art 49 CRR	Danish Compromise: Art. 471 CRR
Own Funds	**Deduction from own funds** of the carrying value of the holding above a **determined threshold**	No deduction *(net of implicit goodwill)*	No deduction *(net of implicit goodwill)*
Capital requirements	The portion of the **non-deducted** holding (within the threshold) is subject to RWA calculation with **250% weighting factor**	**Standard: 100%** RWA (art 133 CRR) **A-IRB: 370%** RWA (art. 155 CRR)	**370% RWA**

Note: The risk weightings presented for the Danish Compromise reflect the current Basel III regulatory framework (Regulation EU No 575/2013). However, these are expected to change with the implementation of Basel IV (Regulation EU 2024/1623), as outlined below.

In a framework aimed at increasing risk awareness, the Basel IV framework, undertakes a comprehensive and profound revision of the system for assessing and calculating risk-weighted assets. In doing so, Basel IV significantly limits the use of internal models, introduced with Basel II, which were deemed to produce, on average, lower capital requirements for the same exposures. Instead, it promotes the use of standardized models, which are deliberately more risk sensitive.

Additionally, to address this model risk, Basel IV introduces output floors when internal models are used, benchmarked against standardized models. These output floors will become relevant for all institutions, regardless of the choice of model employed. Moreover, Basel IV introduces significant changes to the prudential treatment of insurance investments, repealing Article 155 and amending Article 133 of the CRR. These changes include:

- New standard rules for equity investments where no deductions are made, applying a 250% RWA risk-weighting under the Standard Approach.[3]

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[1] With reference to the impacts on Own Funds, the EBA has provided clarification regarding the treatment of goodwill within the context of the Danish Compromise. Specifically, in response to a question submitted in 2021 by a "competent authority" (Q&A 2021_6211), the EBA addressed the issue of evaluating significant investments in insurance companies and determining the amount to be deducted from CET1, as outlined in Article 37(b) of the CRR. The EBA clarified that the goodwill to be deducted must exclusively relate to directly controlled insurance companies and be calculated as of the date of the initial acquisition of the significant investment. Goodwill arising from subsequent acquisitions made by the same controlled companies should not be considered.

[2] Individual threshold of 10% of own funds, which in connection with other cases (i.e. DTA) cannot exceed overall 17.6%.

[3] By way of derogation from Article 133, institutions may continue to assign the same risk weight applicable before the entry in force of CRR III to exposures in equity instruments, to entities of which they were shareholders on the date of adoption of CRR III for six consecutive years and over which they - or together with the network to which the institutions belong - exercise significant influence or control within the meaning of Directive 2013/34/EU or the accounting standards to which the institution is subject under Regulation (EC) No. 1606/2002, or where there is a similar relationship between any natural or legal person or network of entities and an enterprise, or where an entity is able to appoint at least one member of the entity's governing body (Art 495 bis, par 3)

- A transitional period for the Standard Approach, during which the risk weight gradually increases from 100% to 250% between January 1, 2025, and December 31, 2030.

The first gradual step in the transitional period for the risk weight will occur in 2026, from 100% to 130%, followed by 160% in 2027, then 190% in 2028, 220% in 2029, concluding in 2030 with a 250% risk weight.

The amendment further increases the attractiveness of applying the DC framework to entities currently utilizing internal models, thanks to the reduction in the weighting percentage from 370% to 250%. This positive impact is solely relevant to the weighting of insurance participations. These revisions aim to align capital requirements more closely with the risks associated with insurance investments while providing institutions with time to adjust to the new framework.

2.4 Danish Compromise Squared (DC2)

The endorsement of the Danish Compromise in Basel IV, along with some clarifications provided by the EBA on its scope of application, opened new and broader M&A frontiers for banks, evolving from a Danish Compromise to Danish Compromise Squared (DC2).

DC2 opens new possibilities for banks to save capital by risk weighting the goodwill deriving from acquisitions made via their insurance unit rather than fully deducting it from CET1 capital.

As for DC2, banks may seek new growth opportunities acquiring asset and wealth management companies through their insurance units, previously considered unaffordable for banks as excessively dilutive to capital ratios.

BNP Paribas has inaugurated the DC2 in the first large asset management transaction (with AXA IM).

Announced on 01 August 2024 and expected to close by mid-2025, the €5,1bn deal sees BNP Paribas Group acquire a 100% stake in AXA IM through its insurance subsidiary BNP Paribas Cardif. As reported by BNP Paribas Group, the Group has estimated for the acquisition a modest capital impact equal to - 25bps in CET1 ratio. As per Basel IV and the endorsement of DC, the incremental goodwill incurred by Cardif is considered to be outside of the prudential scope of consolidation and therefore risk-weighted at 250%, rather than deducted from BNP Paribas' s capital.

On the Italian market Banco BPM has recently announced a takeover bid on Anima through its insurance subsidiary Banco BPM Vita, with an expected impact of just 30 bps on its CET1 Ratio.

Figure 2: Pro Forma BNP Paribas corporate structure following the acquisition

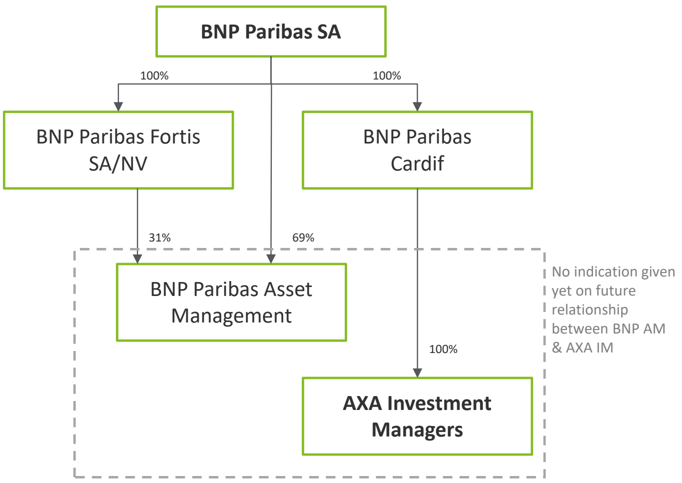

Figura 3: Result of the simulation performed on the BNP Paribas Deal

Data €bn	**Deduction Method**	**Danish Compromise**
CET 1H25	99,0	99,0
Deduct : Intangibles	(4,6)*	-
CET1 1H25 pro forma	**94,4**	**99,0**
RWA 1H25	783	783
Δ 250% Insurance stake	-	11,5
Δ RWA operational	4,3	4,3
RWA 1H25 pro forma	**787,3**	**798,8**
CET1 ratio 1H25	**12,6%**	**12,6%**
CET1 ratio 1H25 pro forma	**12,0%**	**12,4%**
Δ CET1 ratio (%)	(0,65%)	(0,25%)**
Capital impact (€bn)	5,1	2,0

**Max (Equity in the insurance company-10%*Equity in the insurance company;0) as per Art. 48*
***Estimated impact by BPN Paribas*

2.5 Integrated Risk Management

As mentioned in paragraph 2.2. for the adoption of the Danish Compromise *"Competent authorities are required to ensure that the entities within the financial conglomerate maintain continuous adequacy in integrated management, risk management, and internal control systems to uphold the stability and compliance of the conglomerate"*.

In order to allow for the Danish Compromise application, Regulators requires a comprehensive and holistic steering and risk management of Insurance operations at consolidated Group level.

Our understanding of Regulatory Expectations and past experiences is that Banks are required, in particular, to set up a strong integrated risk management framework ensuring all material risks are identified and consistently managed across the entire Bank Assurance Group, also considering for integration and diversification effects of both financial and non-financial risks.

GOVERNANCE AND POLICIES

1. Define Management Bodies, CRO and other control function roles and responsibilities to ensure an integrated risk management
2. Establish Group governance structures for the actuarial calculation model
3. Include Insurance risks (with a focus on ESG impacts) within risk integration procedures
4. Identify adjustments to Risk control policies (e.g., RAF, ICAAP, ILAAP, NII, etc.) and limits
5. Include insurance risk within relevant external and internal reporting

METHODOLOGIES

1. Review Key Risk Indicators 's to include insurance risks
2. Include insurance risks into the RAF (including liquidity, spillover and concentration) and cascade limits to the insurance units
3. Incorporate ORSA into the ICAAP, ILAAP and Pillar 2 risk mapping. Include Insurance units within Non Financial Risk management (e.g., OpRisk, ICT and Cyberisk, etc.)
4. Integrate the Recovery process to include the insurance perimeter
5. Define methodology to calculate additional capital requirement

IT SYSTEMS AND DATA

1. Integrate IT architecture to allow data to be available for Integrated Risk Management and Internal controls activities
2. Set up "core" risk and internal control reporting procedures
3. Ensure compliance with ECB expectations on *Risk Data Aggregation and Reporting* (ref. data governance and data quality)

To set up an integrated and effective risk management framework, Banks need to define a range of actions that involve an update of:

- Governance and internal policies to ensure group risk management procedures are set up and Management Body and Senior Management receive sound reporting about the Group global risk exposures and profile.
- Methodologies in order to define / update Key Risk Indicators to assess and measure risks stemming from insurance operations, include them within the Group Risk Appetite and set up operational limits.
- IT and Data Architecture to ensure relevant data and reporting are promptly available to key stakeholders, meeting Regulatory Expectations on Risk Data Aggregation and Reporting.

Additionally, actuarial expertise is essential for the implementation of the integrated risk management framework, ensuring that the methodologies used to calculate capital requirements for insurance operations are robust, accurate, and aligned with regulatory frameworks and providing ongoing assurance that actuarial models comply with regulatory standards through regular validation, stress testing, and updates in line with evolving regulatory expectations.

This process ensures the models remain reliable and fit for purpose, thereby reinforcing the stability of the conglomerate and its compliance with requirements.

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