



*European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken*



European Supervisory Authorities
Joint Committee
joint-committee@eba.europa.eu,
jointcommittee@eiopa.europa.eu
joint.committee@esma.europa.eu

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Consultative Document *"Joint Consultation Paper on Draft Regulatory Technical Standards on the uniform conditions of application of the calculation methods under Article 6.2 of the Financial Conglomerates Directive"*

JC/CP/2012/02

Ladies, Gentlemen,

The European Association of Co-operative Banks (EACB) welcomes the opportunity to comment on the Consultative Document of the Joint Committee of the European Supervisory Authorities on *"Draft Regulatory Technical Standards on the uniform conditions of application of the calculation methods under Article 6.2 of the Financial Conglomerates Directive"*.

Please find our remarks on the following pages.

We will remain at your disposal,

Yours sincerely,

Hervé Guider
General Manager

Volker Heegemann
Head of Legal Department



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EACB Comments on the ESA's Consultation on the uniform conditions of application of the calculation methods under Article 6.2 of the Financial Conglomerates Directive

Brussels, October 05, 2012



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The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4.000 locally operating banks and 63.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 176 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 50 million members and 750.000 employees and have a total average market share of about 20%.

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1. GENERAL COMMENTS

EACB welcomes the introduction of uniform conditions relating to the calculation of the required capital at the level of financial conglomerates, taking into account the expected come into force of CRD IV - CRR I and Solvency II and the consequent need for adaptation at the level of legislation for financial conglomerates. We consider it desirable to develop common rules for calculation of solvency of financial conglomerates that will maintain the level playing field in the European Union. We note, however, that the requirements proposed by the draft RTS go far beyond the provisions of the Financial Conglomerates Directive (FiCoD) and introduce a new level of standards (cross-sector and sector-specific capital, as well as new requirements on capital transferability). We acknowledge that appropriate consideration to the changes in the sectorial rules should be given, but the substance of FiCoD should not be changed – FiCo requirement should remain a minimum requirement. Moreover, the draft RTS should not raise any level playing field issues between banking-led and insurance-led financial conglomerates in particular, as capital serves the same purpose in both sectors

Buffers should be excluded

Art. 8 states that all capital buffers (systemic, Pillar 2, contra-cyclical, etc.) in both sectors (insurance, banking) shall be taken into account in the calculation of a financial conglomerates capital requirements [(a)] *« including any capital add-on... and any other capital or own funds requirements applicable under Union legislation »* and at paragraph (b) *“combined buffer requirements... and any other requirement applicable under European Union law”*.

Including the buffer requirements or capital add-ons into sectorial solvency requirement is not in line with Fico solvency principles. When calculating the supplementary capital adequacy requirements of a financial conglomerate by applying method 1 (Accounting consolidation) as in Annex I of FiCoD, the own funds and the solvency requirements of the entities in the group shall be calculated by applying the corresponding sectorial rules on the form and extent of consolidation as laid down in particular in Articles 133 and 134 of Directive 2006/48/EC and Article 221 of Directive 2009/138/EC. Directive 2002/87/EC refers to « sectorial solvency requirements », but does not foresee the inclusion of any capital buffers beyond the minimum capital requirements. Thus, the capital add-ons and buffers reference should be eliminated from the RTS.

Counting in the buffers would result in a drastic drop in the solvency ratios of FiCos and would give the wrong view of the loss absorption capabilities of a Fico. In the banking sector, capital buffers are taken into account through an increase of the required solvency ratios but RWAs for FiCo remain calculated in reference to an 8% ratio. Additionally, the



FiCo solvency requirement is a minimum requirement, not flexible, that should not be breached, according to Financial Conglomerates Directive. On the other hand, the CRD IV - CRR I buffers are not part of the minimum requirement, and can be breached and used under certain conditions – they are not minimum requirements. Therefore the solvency requirement of a FiCo becomes unclear by including the sectorial buffers and the principle of minimum requirements as the basis for FiCo solvency requirement (as defined in the Directive) would not apply. Moreover, the countercyclical and systemic risk buffers will be defined at the level of each member state and the countercyclical buffer will be institution specific. Including such buffers could raise concerns relating to the level playing field and will impact the comparability among different FiCos.

Transferability and Availability of Own Funds

EACB has major concerns relating to the definition of “transferable in due course” (i.e. < 3 calendar days to entities subject to the CRR regulation; < 9 months to entities subject to Solvency II). Article 4 of RTS suggests that, for all entities belonging to a financial conglomerates, own funds in excess of solvency requirements would be limited to those that can be transferable in “due course”, without any reference at all to the sectorial regulations. Firstly, the transferability issue is not part of the mandate given to the Joint Committee and significantly changes the level 1 text by introducing additional requirements. Such changes should not be introduced by means of RTS

We understand the concerns of supervisors trying to find a solution in case of a stress period. However, a three calendar days’ timeframe for transferring funds is not feasible at all, taking into consideration weekends and holidays. It is our understanding that when referring to funds, EBA means the narrow understanding of own funds. The transfer of own funds would pose significant concerns as rules are defined in supervisory law as well as corporate law, making it impossible to transfer capital in a matter of days. A more realistic period of 9 months, similar as proposed for the insurance sector, should be foreseen.

In general, EACB is particularly concerned that the difference in timeframes for availability of funds between insurance and banking entities raises a level playing issue, between financial conglomerates, depending on their dominant activity. Moreover, since there is no reference to the sectorial level rules, this provision raises also a level playing field issue between institutions that are financial conglomerates and those who aren’t.

Clarification of timeline

The regulatory timetable is unclear. Recital (17) states that « *it is necessary that the new regime for treatment of methods of consolidation enters into force the soonest possible following the entry into force of the CRD IV - CRR I and Solvency II* », but article 17 only states “*this regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union*”. Generally, EACB believes that



once the CRD IV – CRR I and Solvency II are adopted sufficient time for implementing the changes should be allowed before the new RTS entry into force. Moreover, in order to properly account for the changes in the sectorial frameworks a new consultation should be launched for the RTS on capital calculation methods for FiCos when the underlying provisions (CRD IV/CRR I, Solvency II and potentially FiCoD) are finalized (including level 2 and 3 implementing measures). Only then can a workable solution of uniformly applicable set of methods for calculating the solvency of the financial conglomerate can be found. In addition, an impact study currently takes place on the basis of this consultation paper. It is highly important that insights from this QIS, even if they arrive later than the end of the consultation period of these RTS, should be taken into account.

Eligible items to cover solvency requirements

It is unclear whether all eligible items to cover solvency requirements will be properly considered. There is a discrepancy between article 2 (capital instruments of insurance are defined as *“capital instruments referred to as ‘own funds’ in Directive 2009/138/EC”*). This definition might actually exclude certain eligible items under Solvency II such as *“surplus funds”*) and article 10 of the RTS (capital instruments are defined as *“own funds recognised under sectorial rules”*). EACB suggests referring to *“eligible items to cover solvency requirements in Directive 2009/138/EC”* to clarify the issue.

Sector specific own funds

Article 10 introduces restrictions on sector specific own funds eligible to cover a financial conglomerate solvency requirements. Under the rules proposed by the RTS sector specific own funds wouldn't be eligible beyond the sectorial capital requirements – they cannot be used to cover risks in another sector even if they are in excess of the sector specific capital requirements. This provision is radically different from the 2002 Financial Conglomerates Directive which states at Annex I *« the elements eligible are those that qualify in accordance with the relevant sectorial rules »*

Cross sector own funds

Article 5 requires that cross sector own funds should fulfill 2 sets of requirements (insurance requirements and banking requirements). This provision is also radically different from that of the 2002 Financial Conglomerates Directive. In most cases, it will not be possible to satisfy those conditions, given the more stringent definition of capital under the CRR and the existence of sector-specific criteria in the draft sectorial regulations. Moreover, complexities arise if we consider triggering events of write down or conversion of additional tier 1 instruments under the banking rules that would not correspond to the insurance sector. In addition, basic own-fund items for insurance sector might be either undated or have an original maturity of at least 10 years. These could not qualify as Tier 1 instruments for the banking sector as they are not perpetual.

Article 5 should allow fulfilling only the original sector requirements. Moreover, it should provide that only criteria equally defined in both sectors shall be used to determine whether a capital instrument qualifies or not as a cross-sectorial instrument.



Specific requirements for banking led financial conglomerates

The coordinating supervisor *"after consulting with other competent authorities concerned, shall decide the most prudent method to be applied by the financial conglomerate"* (article 6.2) for banking led conglomerates applying article 46 (1) of the CRR.

This requirement might be understood to imply that, in order to determine the most prudent method, banking led financial conglomerates would have to calculate their financial conglomerate ratio under all three.

There is no reason why only banking led financial conglomerate should apply this rule and moreover, it would be a significant change to the provisions in the CRD currently in force which states at Art. 59 *"Method 1 (Accounting consolidation) shall only be applied if the competent authority is confident about the level of integrated management and internal control regarding the entities which would be included in the scope of consolidation."* This means that only in the case when the competent authority is not confident about the level of integrated management and internal control regarding the entities which would be included in the scope of consolidation, should method 2 or 3 be applied. Hence, it should be clarified that the application of methods 2 or 3 are not necessary if the conditions to apply method 1 are met.

If this requirement refers to applying the most prudent method relating to CRR article 46 (1), the requirement goes beyond the mandates given to ESA, as the method used is defined under CRR article 46. In this case the article 6 paragraph 2 should be deleted.

2. ANSWERS TO QUESTIONS

Question 1:

What are the cost implications of a requirement for conglomerates to follow the clarifications for calculating own funds and solvency requirements described in this paper? If possible, please provide estimates of incremental compliance cost that may arise from the requirements, relative to following the Directive in the absence of the Regulatory Technical Standards.

Implementing the RTS would imply additional costs mostly because it goes far beyond the provisions of the Financial Conglomerates Directive of 2002. In general the RTS will increase the cost because of:

- The requirement to including sectorial buffer requirements into solvency requirements. This will be by far the largest cost and could lead to elimination of most possibilities for capital planning between sectors inside the Fico. The capital requirement should remain at the current design - 8% based on RWA.
- The distinction between cross-sector and sector specific own funds. This requires a complete analysis of all non intra-group capital instruments issued taking into consideration both Solvency II and Basel III eligibility criteria since compliance with



both rules is required for a cross-sector capital instrument. This would lead to a very high cost in terms of financial and human resources.

- The cost of capital for financial conglomerates will increase in comparison to capital issued by financial institutions applying sectorial regulations due to the double compliance rule and transferability in due time rule.
- The need to verify the absence of any practical, legal, regulatory, contractual or statutory impediments to the transfer of own funds for each cross-sectorial capital instruments will also increase the costs. Previously, FiCoD charged supervisors with competent authorities rather than financial institutions with the task to determine such impediments.

Specific to banking led financial conglomerates the incremental cost will be influenced by:

- Requiring from banking side immediate transferability of capital instruments across the whole group. As compared with insurance led conglomerates, banking led conglomerates will be differently affected.
- Requiring from banking led financial conglomerates to fulfill the conditions of article 6(2) of RTS (see general comments - *specific requirements for banking led financial conglomerates*).

Question 2:

How, in your opinion would the proposed clarifications impact on conglomerates' business models?

Question 3:

How far would the suggested clarifications change current market practices?

Generally, it is hard to analyze such impact in a short period of time. However, in this case as well, the new provisions introduced by the RTS, that were not required by FiCoD are considered to have the largest impact on conglomerates' business models:

- As mentioned in the general comments (see general comments – *Buffers should be excluded*) the concept of the FiCo capital requirements is modified by the RTS which make it no longer a minimum requirement. This is a radical change to the definition of capital requirement, modifying the level 1 text and giving a wrong view of the loss absorption capabilities of a Fico. The buffers that are set by national authorities increase the differences in treatment of EU FiCo. The conservation, counter-cyclical and systemic buffers also imply constraints on profit distribution but do not modify the capital requirements calculation.
- “*Transferability and availability*” rule - since there is no reference to the sectorial level rules, this provision raises a level playing field issue, on the one hand, between institutions that are financial conglomerates and those who aren't (discrepancies with the sectorial provisions) and, on the other hand, between financial conglomerates, depending on their dominant activity. Capital serves the same



purpose – absorb losses - so there are no reasons to provide differentiated constraints on transferability.

The definition of impediments to transferability is more restrictive in the RTS as compared to the sectorial rules. This will lead to different treatment of financial institutions depending on whether they are financial conglomerates or not.

The different definition of “due course” in relation to the “funds” for banking and insurance sector might lead as well to different treatment of financial conglomerates depending on whether they are banking or insurance led. The transferability of funds, in the narrow understanding of own funds (or capital terms), is restricted due to company law. Timeframes for own funds transfer to entities subject to the CRR should be harmonized with the timeframe provided for insurance entities (9 months).

Having differentiated conditions depending on the sector might lead to reorienting activities of some groups to avoiding offerings of diversified products in banking and insurance sector at the same time.

- Requiring from banking led financial conglomerates to fulfill the conditions of article 6(2) of RTS (see general comments - *specific requirements for banking led financial conglomerates*) would have a disproportionate effect on banking led financial conglomerates.
- Requirements for cross sector capital instruments to fulfill two set of criteria – qualify as own funds under banking and insurance rules could also lead to avoiding offerings of diversified products in banking and insurance sector by focusing on relevant activities or reduce share of capital in subsidiaries belonging to the secondary sector.

Question 4:

Are the Technical Principles in Title II sufficiently clear? If not, what areas require further clarification?

As mentioned in the general comments:

- Article 2 should contain a reference to: all eligible items in sectorial own funds to cover capital requirements. In this way some items from insurance sector should not be excluded by the unclear wording (e.g. surplus funds).
- Article 5 on *Cross sector funds* should be modified to avoid excessive double requirement for funds that can be transferred across sectors and also to avoid imposing criteria not applicable to both sectors
- Article 7 is rather controversial. It implies that consolidation may be done according to Solvency II for an insurance-led FiCo. Explanatory text states that according to Solvency II multiple use of own funds and intra-group creation of capital should be eliminated. The same basic principles also apply for CRR consolidation. However, method 1 under Solvency II is valuation based while method I under the RTS is accounting based. Article 7 should be deleted as it does not give any guidelines to what end the Solvency II consolidation would be used for, but rather raises potential level playing field issues.



- The restrictions introduced by article 10 on *Sector specific own funds* eligible to cover the financial conglomerate solvency requirements are radically different from the 2002 Financial Conglomerates Directive. The relationship between articles 4 and 10 of the RTS could be further clarified. What could sector specific own funds other than CET1, AT1 or Tier2 under CRR? Are AT1 and Tier2 funds also considered transferable? Generally, further clarification is needed on how to determine transferable own funds from the banking sector.
- Regarding treatment of insurance holdings in a bank led conglomerate (art 11) it should be clarified that in addition to capital charge relating to insurance investment, also the possible expected loss from the insurance investment should not be applied at conglomerate level. Clarification is necessary, since expected loss resulting from IRBA is not a capital charge, but a deduction item and as such is out of scope of article 11 in its present form.

Question 5:

Are there any areas of ambiguity in the way that the Technical Principles in Title II apply to the three consolidation methods?

Article 6(2) relating to the different methods of calculation of capital requirements should contain a clarification that only in the case when the competent authority is not confident about the level of integrated management and internal control regarding the entities which would be included in the scope of consolidation, should method 2 or 3 be applied. In addition recital 12 should be deleted.

Question 6:

Are there any areas of ambiguity in the way that Method 1 needs to be carried out?

One of the main problems and source of ambiguity is the calculation of the consolidated accounts. EACB foresees a problem relating to Article 14 in relation to article 7 and recital 15. As the own funds are calculated on a consolidated basis, also the solvency requirement should be calculated on a Fico consolidated basis as well. However, appropriate guidance on this topic is not given.

Article 14 (8) and related explanations state that for the insurance parts of the conglomerate, the valuation of assets and liabilities according to Solvency II shall be applied in the calculation of Method 1. This ensures consistency between the conglomerate's own fund calculation and the sector-specific own fund calculations. On the other hand, the corresponding explanations determine that the consolidated accounts shall be the basis for the calculation of own funds at the conglomerate level. It is thus unclear, whether a reconciliation of the Solvency II basic own funds to insurance group's contribution to own funds of the consolidated balance sheet value of own funds is necessary or not. The differences in practices between the different countries make it particularly challenging to reach a harmonized approach on this matter. While in some cases the calculation of the capital requirements at the level of FiCo starts from the consolidated accounts by means of



isolating the insurance part and adding it back the insurance contribution calculated under Solvency II, in other cases the calculations start from sector in order to perform a group calculation. In the latter case, for banking led conglomerates if accounting consolidation is a requirement, the RTS would lead to significant additional burden for such conglomerates, in contrast to insurance led conglomerates which could use the scope of consolidation of Solvency II. The text of the RTS remains unclear on this subject.

- Method 1, as currently applied by some banks, is fully based on the accounting consolidation, without any changes to the accounting value of assets and liabilities or any discrepancy between the scopes of accounting consolidation and of supplementary supervision. Recital (15), on the other hand, in relation to Article 14 (8), is taking into account the valuation of assets and liabilities calculated for the purpose of Solvency II in the consolidation accounts. Those valuation rules may be different from the valuation rules used for accounting purpose. This may contradict the provision of Art. 14 (1) which states that “the own funds of a financial conglomerate shall be calculated on the basis of the consolidated accounts (according to the relevant accounting framework)”. In practice, this will actually require the implementation of a specific consolidation procedure only for the calculation of a financial conglomerate observation ratio. Article 14 (1) is unclear in its wording: “the own funds of a financial conglomerate shall be calculated on the basis of the consolidated accounts (according to the relevant accounting framework) applied to the scope of supplementary supervision of the directive”. The last bit of the sentence “applied to the scope of supplementary supervision of the directive” might be confusing as it suggests there may actually be discrepancies between the scope of accounting consolidation and that of supplementary supervision.
- A reconciliation from Solvency II basic own funds to consolidated own funds according to consolidated group accounts which is extremely complex and until now completely unregulated. Additionally there is a discrepancy between the regulation for bank-led and insurance-led conglomerates. For insurance-led conglomerates, following the wording of this draft, the Solvency II-consolidation methodology (Article 7), as well as the respective valuation of assets and liabilities (Article 14), are fully eligible for purposes of Method 1-calculations. Hence, risk-management for insurance-led conglomerates stays within a consistent and reasonable scope of parameters. At the same point of time, bank-led conglomerates are subject to a consolidated accounts perspective with several still unsolved transitional questions leading to parallel risk-management levels, the one based on sector-specific regulatory reporting and the other one based on consolidated balance sheet data.

On the one hand, supplementary supervision should be aligned with the accounting consolidation perimeter, all the more since new accounting standards IFRS 10 would lead to the inclusion of all material risks borne by the conglomerates. The consolidation scope would therefore be aligned with the conglomerates’ exposure to risks. As an example, these new accounting rules can lead financial conglomerates to consolidate SPV depending on the extent to which risks are held by the group. However, the perimeter of supplementary supervision may exclude entities whose inclusion would lead to inappropriate figures, subject to approval by the competent authority on a case-by-case basis (e.g. temporary holdings).



On the other hand, in order to ensure an equivalent level playing field, the RTS should state clearly that for the insurance part of a conglomerate, be it bank- or insurance-led, the Solvency II scope of consolidation (as far as there is no material difference compared to the conglomerate's scope of consolidation), as well as valuation of assets and liabilities is fully eligible for Method 1-calculation purposes without any additional transitional or reconciliation calculations provided that all intra-group aspects have been eliminated. As a consequence, it would be advisable to allow two approaches for calculation of method 1 for banking led conglomerates:

- Calculation of own funds starting from the consolidated accounts
- Calculation of own funds starting from the consolidated position of the two sectors according to sectorial rules and calculation of the FiCo position by means of addition of the position of the two groups where no additional transitional or reconciliation calculations are needed provided that all intra-group aspects have been eliminated

Question 7:

How much of an operational burden is the use of consolidated accounts of the conglomerate as a starting point for Method 1? Is there an alternative more straightforward method/way to eliminate the intra-group creation of own funds?

The highest operational burden for banking led conglomerates would be as a result of the need to provide an accounting consolidation of the insurance part that would require a reconciliation process. This raises level playing field issues as compared with the insurance led conglomerates which use the Solvency II consolidation scope for the entire group. Consolidation is the more straightforward method to eliminate the intra-group creation of own funds. Allowing the treatment suggested in question 6 will be the most appropriate approach

Question 8:

Do you foresee any problems in applying sectorial rules to own funds under Method 1? If so, what refinements to the method would you propose?

This needs to be further analyzed on the basis of the final articles of CRD IV / CRR I and Solvency II (including Level 2 text). Currently there are still no harmonized capital terms or transfer arrangements between the defined sectorial equity categories. Moreover, after the CRD IV – CRR I final texts come into force we do not foresee any additional harmonization of the capital terms. Starting the calculation from consolidated accounts might pose significant difficulties. EACB proposes allowing the treatment suggested in the answer to question 6.

Question 9:

Are there any areas of ambiguity in the way that Method 2 needs to be carried out?



It would be worth clarifying in Art. 15, that intra-group exposures should be eliminated from capital requirements, in order to ensure consistency with the rules applied for capital calculation. Moreover, as already mentioned above, we strongly advocate against taking into account capital buffers in the solvency requirements as this is a radical change to level 1 texts. Having said that, it is worth noting that the inclusion of capital buffers in solvency requirements would lead to significant discrepancies between methods 1 and 2, given capital buffers applied on a solo basis may be far different from those applied on consolidated basis. Method 2 may need further clarifications, following the quantitative impact survey currently in progress.

In addition the method 2 (deduction and aggregation method) presents an important organizational and operational issue. Applying method 2 would result in a fundamental change of the current consolidated principles and tools, including for the accounting aspects. Moreover, the manual elimination of all intra group transactions would be, in particular, burdensome. These manual operations would present a risk in term of reliability as well. Method 2 should not be demanded in case method 1 can be currently applied.

Question 10:

For the purpose of assessing the transferability of “funds” to entities subject to CRR, under Article 4, is “three calendar days” a sufficient timeframe in a period of stress?

Please see the EACB general comments on *Transferability and Availability of Own Funds* and the answer to question 2 on *Transferability and Availability rule*, in particular the comments related to the transfer of liquidity vs. the transfer of own funds, importance of liquidity in stress conditions and timeframes.

Generally three calendar days is not a feasible timeframe taking into consideration weekends and holidays – more appropriate would be 9 months for transfer of own funds to both insurance and banking entities. The restrictions of company law should be considered when talking about transfer of own funds. Moreover, a provision regarding transferability of capital instruments should take into account sectorial rules for both the definition of transferability and of timeframes to avoid level playing problems.