

# **BSG comments on The Joint Committee of the European Supervisory Authorities (EBA, EIOPA and ESMA) public consultation on Draft Regulatory Technical Standards (RTS) for the calculation methods under Article 6.2 of the Financial Conglomerates Directive (FICOD) (JC/CP/2012/02)**

The European Banking Authority Banking Stakeholder Group (BSG) welcomes the opportunity to provide responses to the Joint Committee of the European Supervisory Authorities public consultation on Draft Regulatory Technical Standards (RTS) for the calculation methods under Article 6.2 of the Financial Conglomerates Directive (FICOD) (JC/CP/2012/02).

- **Art. 2** (Eligibility own fund items for insurance activities) states that capital instruments of insurance are defined as "capital instruments referred to as 'own funds' in Directive 2009/138/EC". This could be interpreted as actually excluding certain eligible items under Solvency 2 that are not explicitly included in the definition of "own funds" set out at Art. 87 of the Solvency 2 Directive. It would thus be advisable to refer to "eligible items to cover solvency requirements in Directive 2009/138/EC". However, Art. 10 which defines sector specific own funds mentions "own funds recognised under sectorial rules". It is thus unclear whether all eligible items to cover solvency requirements are actually eligible to cover insurance capital requirements as part of the financial conglomerates supervision. This needs to be clarified.
- **Article 4** (transferability and availability of own funds): for all entities of a financial conglomerate, own funds in excess of solvency requirements would be limited to those "transferable in due course" (i.e. in less than 3 calendar days to entities subject to the CRR regulation and in less than 9 months to entities subject to the Solvency 2 regulation). This is significantly different from the sectorial regulations that do not provide any timeframe requirements for transferability and goes far beyond the provisions of the Financial Conglomerates Directive which states, at Annex I, that "when calculating own funds at the level of the financial conglomerate, competent authorities shall take into account the effectiveness of the transferability of own funds". That requirement does not mean that capital should be liquid within a financial conglomerate. Moreover, this provision raises level playing field issues: between institutions that are financial conglomerates and those which are not due to discrepancies between transferability under the draft RTS and transferability under sectorial regulations and between financial conglomerates themselves, depending on their dominant activity, as different timeframes are provided for each sector. Finally, it is questionable whether a reallocation of capital within a financial conglomerate decided in an emergency situation would actually resolve a rapid and sudden deterioration in confidence due to liquidity issues. In any case, there are no reasons to provide different timeframes for insurers and bankers with respect to transferability and a 3 calendar day's timeframe is simply impossible to be implemented, from a practical standpoint, because of legal constraints imposed by company law. Should the ESAs decide to maintain a timeframe requirement in the RTS, 9 months should be required for both sectors.
- **Article 5** (cross sector own funds) provides that, when a shortfall of capital exists at group level, it should be covered by cross-sector own funds. Cross-sector own funds should fulfill 2 sets of criteria applicable to capital instruments (insurance and banking criteria). 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 sectoral regulations (e.g. 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 the 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. It is the BSG view that Article 5 should:

- allow fulfilling only the original sector requirements (when the deficit of capital at group level is attributable to one sector) or,
  - allow fulfilling the set of criteria applicable to the dominant sector or to the head of a group or,
  - provide that only criteria equally defined in both sectors should be used to determine whether a capital instrument qualifies or not as a cross-sectorial instrument.
- **Art. 6 (2)** and recital 12 (more stringent provisions applicable to banking-led financial conglomerates): in the case of banking-led conglomerates, the coordinating supervisor would have to choose the most prudent method between methods 1, 2 and 3. As this requirement applies to banking led financial conglomerate only, it would also raise a level playing field issue and would lead to 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." The Art. 6(2) of the draft RTS may also imply that banking led financial conglomerates would have to calculate their financial conglomerate ratio under all methods in order to determine the most prudent one. As a consequence, in order to avoid ambiguity and any level playing field issue and to ensure consistency with the CRR, the BSG suggests clarifying this RTS by deleting recital 12 and replacing Art. 6(2) by the following paragraph "Method 1 shall apply, provided that the level of integrated management, risk management and internal control regarding the entities included in the scope of consolidation under method 1 is adequate. If this condition is not met, competent authorities will require a financial conglomerate to apply either method 2 or 3".
  - **Article 8** (buffer requirements): all capital buffers (systemic risk buffer, Pillar 2 buffers, contra-cyclical capital buffers etc.) in both sectors (insurance, banking) are taken into account in the calculation of financial conglomerate solvency requirements. In the banking sector, capital buffers are taken into account through an increase of the required solvency ratios but the RWAs remain calculated in reference to an 8% ratio, as stated at Art. 87 of the draft CRR. Moreover, the conservation and systemic buffers imply constraints on profits distribution but do not modify the capital requirements calculation itself. Thus, Article 8 is a major change in comparison to the draft sectorial regulations.

However, Directive 2002/87/EC does not deal with capital buffers or with Pillar 2. The Joint Forum itself does not require a capital buffer at the financial conglomerate level which would be the sum of the banking and insurance activities' Pillar 2. Going one step further, it would be difficult to argue that the risk of combined banking and insurance activities is equal to, or greater than, the sum of these two activities' standalone risks. Nothing in recent events supports this statement. This comment applies in the same way to capital buffers. Therefore, any mentioning of "capital add-ons", "buffers" or "any other requirement applicable under European Union law..." should be removed from the definition of capital requirements, as part of this RTS.

The solvency requirement for banks is defined by Art. 87 (1) of the draft CRR as the following own funds requirements:

- (a) a Common Equity Tier 1 capital ratio of 4.5%
- (b) a Tier 1 capital ratio of 6%
- (c) a total capital ratio of 8%.

Capital buffers, and more generally Pillar 2, are not part of these requirements. And the same applies to the insurance sector.

For its part, Annex I to the Directive states that:

Annex I - Technical principles (I.2): [...] pending further harmonisation of sectoral rules, the solvency requirements for each different financial sector represented in a financial conglomerate shall be covered by own funds elements in accordance with the corresponding sectoral rules.

Therefore, Article 8 should be modified as follows:

**For the purpose of the calculation of the supplementary capital adequacy requirements of the regulated entities in a financial conglomerate, a solvency requirement shall satisfy either of the points laid down in (a) and (b):**

- (a) Where the rules for the insurance sector are to be applied, solvency requirement means the Solvency Capital Requirement as defined by Article 100 or 218 of Directive 2009/138/EC as applicable, including any capital add-on applied in accordance with Articles 37, 231(7) or 232 of the same directive as applicable, and any other capital or own funds requirement applicable under Union legislation.**
- (b) Where the rules for the banking or investment services sector are to be applied, solvency requirement means the sum of own funds requirements as defined by Articles 87 to 93 of CRR, combined buffer requirements as defined by Article 122 of CRDIV, and specific own funds requirements as defined by Article 100 of [CRDIV], and any other requirement applicable under European Union law.**

Last, Annex I to the Directive does not ask for any solvency ratio at the financial conglomerate level. In the three methods, "the supplementary capital adequacy requirements shall be calculated as the difference [...]. The difference shall not be negative". To avoid any ambiguity, this principle should appear in Article 14 (Technical calculation methods) of the RTS, at its very beginning, and also in its Executive Summary (see: Technical calculation methods).

Article 46 (3b) of the draft CRR calls for a solvency ratio at the conglomerate level. Even if the concept of a conglomerate ratio were to be maintained in the level 1 CRR text, it would not be legally acceptable to define it as proposed under the RTS (i.e. by including all capital add-ons and capital buffers in the solvency requirements) as it would basically amount to making Pillar 2 notions public, which is strictly prohibited by law. An alternative way that would be consistent both with the CRR and the Solvency 2 directive would involve in consistency with CRR if confirmed, disclosing a coverage ratio calculated as total capital at group level in accordance with this RTS, divided by the sum of minimum requirements provided in sectorial regulations, taken into account adjustments required by the RTS, but which would need to take into account the other comments of this document.

Should a coverage ratio be required under art 46 of the CRR, it would be advisable to clarify how it should be calculated using method 2.

- **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 regulatory

capital calculation and the insurance regulatory capital calculations. On the other hand, the corresponding explanations determine that the accounting 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 will be necessary or not. In the latter case, for banking led conglomerates if accounting consolidation is a requirement, taking into account valuation of assets and liabilities according to Solvency II, the RTS would lead to an additional burden for banking-led financial conglomerates, in contrast to insurance led conglomerates which could use the scope of consolidation of Solvency II according to Article 7. It is the BSG's view that the text of the RTS should be clarified on this subject.

- **Article 17** (enter into force) states that "This regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union." On page 13, point 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 CRR/CRD IV and Solvency II". It is the suggestion from the BSG that article 17 should be completed by the following sentence "Until CRR/CRD IV and Solvency II have both entered into force, financial conglomerates have to comply with the national transpositions of Directives 2002/87/EC and 2011/89/EU".