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

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Joint Forum
Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
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Consultative Document ***"Principles for the supervision of financial conglomerates"***

Ladies, Gentlemen,

The European Association of Co-operative Banks (EACB) welcomes the opportunity to comment on the Basel Committee on Banking Supervision's Consultative Document on *"Principles for the supervision of financial conglomerates"*.

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

General remarks

- We generally support the principle-based approach of BCBS and its concept of a risk oriented application of these principles. The new principles seem comprehensible and go in the right direction as regards the banking and insurance supervision. However, some of them (12(ii), 13 to 17 and 19 to 29) grant too much discretion to the supervisors. In order to guarantee a level playing field, there should be common guidelines in each case. With this in mind, it is worth recalling that, the European Union has developed, already since 2002, a robust financial conglomerate prudential framework providing for a sound development and oversight of the "bank-insurance" model (Directive 2002/87/EC). This European Financial conglomerates legislation has been slightly updated in December 2011. So many issues raised in the Joint Forum's consultative paper are already carefully addressed in the European financial conglomerates framework.

  Therefore, in this context we believe that the priority for regulators at international level should lie first and foremost in the effective implementation of the Basel 3. In addition, it is necessary to take into account the implementation of the Basel III rules for banks at European level in the form of CRD4/CRR and also the new rules for insurance companies at European level - Solvency 2 to secure an even level playing field.

- Specifically, as regards the Joint Forum principles, these should be limited to the supervision of the specific complementary aspects of financial conglomerates and not lead to a duplication of requirements of the sectoral supervision. Moreover they should find their limits where mandatory company rules or factual circumstances hinder their application. This is usually the case when an undertaking belongs to two financial conglomerates. The influence of minority shareholders regarding the risk management, remuneration, and capital or liquidity requirements is clearly limited. In specific cases (such as minority participations) national authorities should have the right to exclude minority shareholders from the application of the principles in part or completely.

- A more comprehensive risk management framework for the financial conglomerates could rather be achieved by harmonising the core principles of supervision for banks and insurance. These core principles would have to take into consideration the differences of risks between the two areas of activity and the differences in internal harmonisation in banking and insurance supervision. The core principles should preserve sectoral rules when dealing with capital adequacy and solvency issues.

- In certain jurisdictions the requirements under sectoral regulations include the risk of double-counting of capital requirements as capital buffer and the risk-sensitive principles of capitalizations. In addition there is specific regulation applicable to financial conglomerates. We believe that these should be taken into account when considering the additional capital buffer at the level of conglomerate. Moreover we believe that there

are diversification benefits deriving from risk aggregation which should be recognized by the in the principles for capital adequacy. It is difficult to argue the opposite since the recent events have demonstrated that the insurance activities have softened the effects of the subprime crisis on the P&L and capital base of the financial conglomerates as shown by surveys carried out by the industry.

- We support a global supervisory oversight of financial conglomerates and we believe in this context it is relevant the use of a "baking pillar II" approach. However we call for careful consideration of the additional capital charges since this approach could prove to be risky and could lead to jeopardizing the current principle of a capitalisation by risk type, based on confidence levels fixed at sectoral levels.

Part II - Supervisory responsibility (from §5 to §9)

§ 5 - Group-level Supervisor

- It is important to note that sectoral supervisors have the advantage of sharing a common supervisory framework. In the case of supervision at the level of financial conglomerates this will change. It is thus very important to define the responsibilities of the Group-level supervisor vis-à-vis the other supervisors.

- The supervision of financial conglomerate is a group level supervision. As clearly described in the explanatory remarks 5.3 of the consultation paper, the sectoral supervision is done at the level of individual entities. However due to the possible heterogeneous background of all the participating supervisors there might be different views among relevant supervisors on various issues pertaining to the supervision of a financial conglomerate. We consider that the final say should be given to the group-level supervisor

- The consultation paper, in most of the cases, employs the general term "supervisors" and does not allow a clear distinction between group-level supervisors and sectoral supervisors. One of the cases where it is not clear which level of supervision applies is Principle 10. The responsibility for corporate governance supervision for the financial conglomerate as a whole should lie with the group-level supervisors. It is confusing to use the general term in this context. In order to avoid any future misunderstanding, we encourage the clear indication of which supervisory authority the text refers to.

- The principles should insist on the need to develop a common supervisory language and culture since supervisors might be in charge of very different businesses with are subject to different prudential rules.

§ 9 – Supervisory tools and enforcement

- As regards paragraph 9.2 - "*sanctions and corrective actions should be used to address sources of risks or issues of non compliance and may include, but are not limited to, restricting current of future activities, suspending dividend to shareholders of relevant entities within the financial conglomerate and other measures to prevent capital from falling below the required levels*" – a clarification is needed. Such sanctions should only be used to address issues relating to financial conglomerates' supervision and should not seek to address any potential sectorial issues.

Part III - Corporate governance in financial conglomerates (from § 10 to § 14)

§ 10 - Corporate governance in financial conglomerates

- Unregulated entities should not be subject to sectoral provisions. Applying sectoral rules to unregulated entities would potentially generate level playing field issues

§ 11 - Structure of the financial conglomerate

- Supervisors should have no role in defining organizational or managerial structure; these should be at the sole discretion of the financial conglomerates and its entities.

Part IV - Capital adequacy and liquidity (from §15 to §20)

§ 15 - Capital management requirements

- We believe that it is important that unregulated entities that are part of a financial conglomerate are not treated differently than the unregulated entities which are part of other regulated financial groups. The interaction between unregulated entities and regulated entities should be taken into account as "environmental" factors as part of the Pillar 2 Supervisory Review and Evaluation Process.

- We support the requirements according to which financial conglomerates should manage their capital through a rigorous, board-approved, comprehensive and well documented process. However, it should be noted that the requirements # 15(e) to 15 (l) regarding capital planning of financial conglomerates are far more detailed and prescriptive than those existing under any of the sectoral regulations (eg. Basel 3, Solvency 2 in the EU).

- We support the application of the principle of proportionality to requirements in paragraph 15. The group level supervisor should determine more precisely which requirements are relevant for a financial conglomerate under its supervision, having regard to its risk profile and taking into account the existence or not of a specific

regulation applicable to financial conglomerates in its jurisdiction. This would be particularly important for financial conglomerates in the EU with a lower risk profile focused on retail customers and already subject to a supplementary supervision.

§ 16 - Capital adequacy assessment

- There are some concerns regarding the expectations towards the financial conglomerates as formulated under Principle 16 – Adequacy assessment. From a prudential perspective Basel II/III and Solvency II provide different prudential rules for different sectors for the (external) assessment of the capital adequacy. However, these regimes can be compared only to a limited extent. It still has to be defined whether for the assessment of capital adequacy the prudential standards should be relevant or rather the internal reporting system should be used. Pending on the outcome of this decision we consider that some of the principles proposed should be reconsidered (16B, 16 D).

- The circumstances and the criteria according to which, supervisors could require group-wide capital to exceed regulatory minimums should be set. The targets should be clarified taking into account the existing buffers at the level of both the banking and insurance activities prior to applying such requirements at the financial conglomerate level

- It is necessary to define the localisation of a potential capital buffer within the group: are we talking about one buffer or about multiple sectoral buffers?

- In addition the way unregulated entities should be brought into the group-wide capital assessment should be clarified (see point 16(a) of the consultation document: "via capital proxy or through deduction").

§ 17 – Consideration of double or multiple gearing

- At the European level, the Financial Conglomerate directive already requires the calculation of supplementary capital adequacy requirements (§ 17.c) which aims to control and prevent the risk of double or multiple use of capital. It should be stated that the specific requirements under paragraph 17 should only apply when there are no similar requirements in the regulation applicable to financial conglomerates established in their jurisdictions.

- Moreover we believe that it is necessary, in line with current rules at European level that the requirements of Principle 17, also applicable at Basel level, allow credit institutions under prudential rules not to deduct holdings in insurance undertaking, so that an adequate capital allocation within both sectors can be possible.

§ 20 - Liquidity management

- Under Basel III there are already adequate rules for the management of liquidity risk in banking groups. The requirements to manage liquidity risk at the level of the conglomerate go beyond the existing measures at the sectoral level.

- Moreover this is a banking concept which may become irrelevant in a financial conglomerate context. Insurers are pre-funded by premiums rather than relying on short-term debt to a significant degree or accepting deposits from the public. An insurer would be expected to become insolvent long before it becomes illiquid. Moreover a liquidity ratio at the level of financial conglomerates would be very difficult to define as the business behind balance sheet structure is very different in banking and insurance entities.

- Furthermore, with regard to the liquidity management at the conglomerate level we would like to draw attention to the fact that the possibility of the parent company to interfere (head of the financial conglomerate) is only given if similar waiver schemes as those existing for banking sector are also observed at conglomerate level, otherwise the legal possibilities for liquidity control are missing.

Part V - Risk Management (from §21 to §29)

§ 24 - New business

- With regard to the principle 24 – New businesses – we suggest that the compliance with the principle is ensured at the conglomerate level when each individual entity fulfills the relevant sector specific requirements. From a prudential perspective and according to the company law the extension to the conglomerate level is in the responsibility of each individual entity. Moreover since a convergent product/business orientation is missing, a centralized process brings little added value.

§ 26 - Stress and scenario testing

- We acknowledge usefulness of stress testing and scenario analyses in providing information to senior management about alignment of the institution's risk profile with the Board's risk appetite under various circumstances.

- However, performing such analysis in the context of financial conglomerates will come across practical limits due to the heterogeneity of the business models and natures of the risks of the different parts of the conglomerate. In addition appropriate handling time for the relevant scenarios will be necessary

- The methodology to perform such analysis should not be too prescriptive as the diversity of financial conglomerates' risk profiles and business models could not be captured by a "one size fits all" approach. Moreover taking into consideration that the conglomerate can deliver the best assessment risk structure we believe that the required flexibility and variability of the analysis is too far reaching and, for practical reasons, hardly feasible.

- Consequently, we believe that the implementation of such analysis developed at the level of the individual sector should simply be executed at conglomerate level.

- Moreover it is not clear what impact should the results of stress testing analysis have on management of the conglomerate. It is not always possible, due to company law restrictions, to establish a centralized control and allocation of funds.