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FRENCH BANKING FEDERATION RESPONSE TO PUBLIC CONSULTATION ON THE DRAFT RTS ON THE METHODS OF PRUDENTIAL CONSOLIDATION

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

The FBF welcomes the opportunity to share its comments on the EBA’s consultation paper on the methods of prudential consolidation.

1- Scope of application

Q1. Are there undertakings which do not comply with the definition of a financial institution or ancillary services undertaking of Regulation (EU) 575/2013 which should be included in the prudential scope of consolidation? Please explain and provide examples of these entities.

FBF answer:

We understand that the EBA has identified a need for clarification of the definitions of financial institutions or ancillary services undertakings, which definitions are key to define the prudential perimeter and as consequence to promote the level playing field by ensuring the consistent treatment of prudential risks.

In our opinion, given the current CRR framework, there are no entities that are not included in the scope of prudential consolidation and that should be included.

While we understand that article 18(7) of Regulation (EU) 575/2013 gives a clear mandate to the EBA to specify the conditions according to which consolidation shall be carried out, the EBA has no mandate to provide additional clarification to definitions of financial institutions and of ancillary services undertaking.
Moreover, as the EBA does not have the mandate to transpose international standards into European law, only the European Commission has the initiative for such actions.

Therefore, the implementation of these RTS should not be used as a vehicle for even a partial attempt to transpose the Basel standards. It should also be noted that the Commission is currently working on amendments to Article 18 as part of the future revision of the CRR/CRD.

However, should the scope of application be clarified, the following elements should be taken into consideration:

- Prudential consolidation should not apply to entities that are out of the accounting consolidation perimeter.
- The perimeter for prudential consolidation is a subset of the accounting one as it excludes undertakings that do not bear financial risks similar to those of banks.

**Q2. Do you consider SSPEs financial institutions? When SSPEs are consolidated for accounting purposes, do you also consolidate them for prudential purposes? Please differentiate in your answer between the situation when SRT is met and when it is not met (the institution originates the securitisation); and when the institution acts as an investor on the securitisation vehicle (whether this is a SSPEs or a special purpose entity used to set up securitisations) or sponsors the securitisation transaction.**

**FBF answer:**

The notion of SRT should not interfere with the scope of the prudential consolidation perimeter. This notion should only be considered as a measure of risk for solvency purposes rather than as an indicator for inclusion in the prudential consolidation perimeter.

Indeed, when the institution originates the securitization, the solvency treatment depends on the SRT achievement:

- When the SRT is met and the SSPE is not controlled by the institution, the securitized assets should not be consolidated for prudential purposes in application of prudential securitization framework (as if the SSPE would fall outside of prudential consolidation perimeter). In this situation, the CRR framework - Chapter 5 of Title II, Part Three and Article 337 of Regulation (EU) N°575/2013 - as modified by the regulation (EU) 2017/2401 applies to securitization exposure retained by the originator.

- When the SRT is not met and the SSPE is controlled, the securitized assets should remain in the balance sheet of the originator (the loans cannot be excluded from the credit risk framework) as the securitization transaction is not recognized from prudential point of view (as if the SSPE would fall in the prudential consolidation perimeter). The securitization transaction is without any effect on the prudential situation.

When SSPE is consolidated for accounting purposes and the institution is an investor (and/or the sponsor), equity method should be used whatever the retained accounting treatment (global integration or equity method). This approach shall apply in particular for ABCP conduit. In this situation, the CRR framework - Chapter 5 of Title II, Part Three and Article 337 of Regulation (EU) N°575/2013 - as modified by the regulation (EU) 2017/2401 applies to securitization exposure hold by the investor.
2- Permission for proportional consolidation of subsidiaries

Q3. Do you currently use the method of proportional consolidation for the consolidation of subsidiaries in accordance with Article 18(2) of Regulation (EU) No 575/2013? If proportional consolidation is used, please explain if the conditions included in Consultation Paper are met.

FBF answer: As mentioned in the consultation paper, article 18(2) of CRR has been used for a limited number of institutions that were not material.

Q4. Do you have any comment on the conditions established in this Consultation Paper to apply proportional consolidation pursuant to Article 18(2) of Regulation (EU) No 575/2013?

FBF answer: no comment. As mentioned in the consultation paper, article 18(2) of CRR has been used for a limited number of institutions that were not material. And in the context of the CRR review, this article is expected to be removed.

3- Determination of the consolidating entity in case of groups of undertakings managed on a unified basis or by the same persons

Q5. Do you agree on the criteria for the determination of the consolidating entity? Do you experience a different situation currently?

FBF answer:

The article 18(3) requires to apply the aggregation method as proposed in the Accounting directive when conditions for prudential consolidation are met.

However, the detailed criteria for the determination of the consolidating entity as specified in the article 8 of the draft RTS may raise interpretation issues for mutual banking groups. A literal reading of the text that designates the entity responsible for the consolidation in the absence of a parent – subsidiary relation may be inconsistent with existing national regulations that should be taken into consideration on that matter.

Accordingly, we suggest amending Article 8(2) of the draft RTS as follows:

“Where there are institutions established in one or more Member States within a group of undertakings which are managed on a unified basis or by the same persons pursuant to Article 22(7) of Directive 2013/34/EC and Article 18(6)(b) of Regulation (EU) No 575/2013, the consolidating entity is:

- determined in taking account of the specific provisions in the national regulation that already define for accounting purposes the criteria for determining the consolidating entity or the consolidating entities, or
- the institution with the largest balance sheet total, resulting from the latest audited consolidated financial statements, where prepared, or in the cases where consolidated
financial statements are not required to be prepared, the latest audited individual financial statements.

**Justification**
Some savings banks already have several consolidating institutions for their accounting consolidation (in accordance with the accounting French Regulation CRC 99-07 paragraph 1001, based on French Monetary and Financial Code). This treatment has been approved by auditors. As a consequence, this treatment has been used for prudential consolidation. Yet, it seems necessary to take account of provisions already in force in accounting regulations, which allow a correct representation of the economic and juridical situation of mutual groups and as a result to provide a better view of the risk at a consolidated level.

4- **Method for prudential consolidation**

Q6. Do you have any comment on the elements included in this Consultation Paper for the application of the ‘aggregation method’ pursuant to Articles 18(3) and (6)(b) of Regulation (EU) No 575/2013? Please explain.

FBF answer:
We understand the aggregation method is a valid method pursuant to Article 18(3) and (6) of CRR for undertakings managed on a unified basis. In this situation, we expect undertakings be supervised on a consolidated basis to ensure a level playing field, in particular between countries participating in the Single Supervisory Mechanism (SSM).

In particular, the aggregated balance sheet is the right level to determine the conditions of application of Directive 2013/36/EU (CRD) in relation to the assessment of other systemically important institutions (O-SIIs) and of global systemically important institutions (G-SIIs).

5- **Conditions to apply proportional consolidation**

Q7. Do you have any comment on the application of proportional consolidation according to Article 18(4) of Regulation (EU) No 575/2013?

FBF answer:
According to the EBA proposal, proportional consolidation should not be applied where the four conditions are not all fulfilled.

We question the relevance of the condition #4 (i.e. there is no enforceable contract establishing that the liability of the participating undertakings is limited to the share of the capital each party holds in the undertaking). Indeed, the condition #4 does not exist in the accounting provisions that define consolidation of joint arrangement. As a consequence, the proportional consolidation, that is currently used even if the condition #4 is not met, could no longer be used in these instances. Therefore, the question arises as to whether the prudential treatment of these instances falls under the article 11 of the draft RTS applies and, as to whether, as a consequence, the consolidation method to apply for prudential purposes is the equity method.
We suggest to delete the condition #4.

6- The prudential treatment of other participations or capital ties under Article 18 (5)

Q8. Do you have any comment on the criteria established in this Consultation Paper on the prudential treatment of other participations or capital ties (including the equity method) under Article 18(5) of Regulation (EU) No 575/2013? Please explain.

FBF answer:

We believe that clarification is needed regarding the linkage between art 18(3) of the CRR, the article 11(3) of the draft RTS and the explanatory box, as applied to insurance entities1 where it is said that, whilst institutions have to decide on a valuation of the participation not included in the scope of the prudential consolidation, competent authorities have the discretion to review the valuation method and potentially put into question the current application of the equity method.

It is unclear what is meant by “the review of the valuation method”.

We are aware that the EBA is not intending to change the scope of application of the consolidation perimeter within the draft RTS. Nevertheless the article 11(3) of the draft RTS may be misleading as competent authorities have the right to impose a valuation method for insurance entities that are excluded for the prudential scope of consolidation but fully or proportionally consolidated under accounting standards.

We believe that the draft RTS should take into consideration the proposal of the European Council regarding article 18 of the CRR concerning the treatment of insurance entities in the context of prudential consolidation. The presidency proposal introduces an explicit provision determining that institutions should use the equity method for insurance entities falling outside the scope of prudential consolidation. It clarifies that the equity method does not constitute inclusion of those entities in supervision on a consolidated basis. We believe that such proposal would have the merit to harmonize the prudential treatment within EU and to ease comparability.

We strongly advocate that the EBA should review the article 11(3) and that the EBA should clearly specifies in the draft RTS that the institutions should use the equity method for insurance entities2 and that the insurance sector entities are excluded from the scope of banking prudential consolidation under the CRR.

Besides, the draft RTS has also taken into consideration the work of the BCBS on the identification and management of step-in risk.

1 And in general all entities that are not “undertakings” as defined in article 2 of the RTS (Credit Institution, Investment firm, Financial institution, Ancillary Services) which are fully or proportionally consolidated for accounting purposes

2 And in general all entities that are not “undertakings” as defined in article 2 of the RTS (Credit Institution, Investment firm, Financial institution, Ancillary Services) which are fully or proportionally consolidated for accounting purposes
However, we have the following comments regarding the links between step-in-risk and the scope of consolidation.

- Banks’ self-assessment of step-in-risk seems to have the same consequences under the BCBS guidelines and under the draft RTS. BCBS step-in-risk guidelines do not necessarily modify the scope of the consolidation but require banks to assess whether entities pose a significant step-in-risk and requires banks and supervisors to determine the appropriate choice of measure when a bank identifies significant step in risk to an entity (these measures include not only the inclusion in the regulatory scope of consolidation, but also a conversion approach, stress testing, provisioning…). whereas, according to the draft RTS, the competent authority assesses the risk posed by an undertaking and may require the prudential consolidation of undertakings that implies a Pillar I approach.

- Regarding the step-in-risk, we would like to reiterate the comments made into the BCBS Consultative document Identification and measurement of step-in-risk of December 2015. Since the crisis and following G20 recommendations accounting standards on consolidation have changed in Europe as well as in the USA which led banks to re-consolidate many entities and as a consequence many assets.

The current IFRS 10 standard on consolidation has become effective on the 1st of January 2014. Under IFRS 10 consolidation in financial statements is required when an entity is exposed to variables returns from another entity and has the ability to affect those returns through its power over the other entity. More formally IFRS set out three elements of control: power (over the investee), exposure to variable returns from involvement with the investee and the ability to use power over the investee to affect the amount of the investor’s returns.

The notion of variable return encompasses the notion of exposure to risks. Furthermore, an implicit or explicit commitment to ensure that an investee operates as designed may be an indicator that an entity has power, but does not by itself give an investor power (cf. IFRS 10 B54). As a consequence, reputation risk has to be considered in the consolidation analysis even if this risk is not sufficient by itself to conclude on the control. At least, the threshold for consolidation is set at a relatively low level in terms of exposures to variability (cf. IFRS 10 B72, example 14B which points out “For example, having considered its remuneration and the other factors, the fund manager might consider a 20% investment to be sufficient to conclude it controls the fund.

Moreover US accounting principles (US GAAP) and IFRS principles regarding consolidation being globally consistent it is possible to map them. For all these reasons we consider that the prudential perimeter should not include more undertakings than the accounting consolidation perimeter (as defined according to IFRS principles) which would enable to meet the aims pursued by the EBA, namely to promote the level playing field by ensuring the consistent treatment of prudential risks, without being unduly conservative.

- The reputational risk that a bank intends to mitigate by supporting an entity is already captured in Pillar 2 and therefore the need for additional capital requirement is questionable.
As a conclusion, and as already mentioned in our comments to the BCBS consultation on step in risk of 2016, we believe that only a Pillar 2 approach should be considered to address such a step-in risk if the Committee believes that the current Pillar 2 guidance on reputational risk and implicit support needs to be strengthened.

At any rates, since the EBA has observed divergent practices among the National supervisory agencies, we do not believe that the step-in risk can be correctly assessed if it remains at the hand of the NSA and they are not guided by detailed principles such as those set out by the BCBS or the Accounting standard setters.

7- **Other**

Q9. **Do you agree with the impact assessment and its conclusions? Please provide any additional information regarding the costs and benefits from the application of these draft RTS.**

**FBF answer**

We have no specific comments on the impact assessment and its conclusion.

Q10. **Please provide any additional comments on the Consultation Paper.**

**FBF answer.**

We expect that the level of supervision reflects the consolidated perimeter, regardless the consolidation methodology (global integration, proportional integration, equity method or aggregation).