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

CEBS
Committee of European Banking Supervisors
Expert Group on prudential Regulation
Drafting team on Article 3

cp41@c-ebs.org

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VH/WSC/B2/

CP 41 on CEBS's Guidelines regarding revised Article 3 of Directive 2006/48/EC

Dear Mr. Holtring and Mrs. Luz,

The European Association of Co-operative Banks (EACB) welcomes the opportunity to provide final comments on CP 41 CEBS Draft Guidelines relating to the interpretation of Article 3 of Directive 2006/48/EC as amended by CRD II.

We would like to thank CEBS for the opportunity to provide technical comments and input on this matter which is highly important for cooperative banks.

While CP 41 addresses most aspects in an appropriate way, there are still remaining issues to which we would like to draw your attention. In particular a clarification of the notion of affiliation and the scope of application of the guidelines are required as well as an approach on the EU passport which reflects reality.

We remain at your disposal for any further questions or requests for information.

Yours sincerely,

Hervé Guider
General Manager

Volker Heegemann
Head of Legal Department

Rue de lôIndustrie 26-38 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Fax (+32 2) 230 06 49 • e-mail : secretariat@eurocoopbanks.coop
European Commission Register of Interest Representatives Identification Number 4172526951-19
www.eurocoopbanks.coop • e-mail : secretariat@eurocoopbanks.coop

GENERAL REMARK

The Members of the EACB support the aim of CEBS to draft clear guidelines on the application of Article 3 of CRD II in order to enhance the convergence of supervisory practices in this regard and to ensure equal conditions for competition between credit institutions in Member States.

With regard to the different practices and organizational structures of the cooperative groups concerned, it is not possible to fulfil every single detail or requirement by the letter. We will provide examples in more detailed remarks. Therefore, the guidelines should remain focused on principles rather than details in order to achieve the main purpose of Article 3 as stated in para. 6 of CP 41.

SPECIFIC REMARKS

1. Objectives and methodology

The EACB agrees that the objective of CEBS guidelines is to enhance the convergence of supervisory practices on the application of Article 3 CRD across the EU.

In addition, we concur that the main purposes of Article 3 as modified by CRD II is to clarify that the central body and its affiliates form a unity and to ensure 'where appropriate, equal treatment of Groups as defined in this article vis-à-vis credit institutions with a (vast) number of branches' (cf. para. 6 of CP 41).

2. Scope of application

Article 3 allows each competent supervising authority to provide for exemptions from prudential requirements in favour of certain affiliated credit institutions referred to above provided that:

- the credit institutions are permanently affiliated to a central body,
- the commitments of the central body and the affiliated institutions are joint and several liabilities or the commitments of such affiliated institutions are entirely guaranteed by the central body,
- the solvency and liquidity of the central body and the affiliated institutions are monitored as a whole on the basis of consolidated accounts, and
- the management of the central body is empowered to issue instructions to the management of the affiliated institutions concerned.

a) Levels of Consolidation

Notice should be taken of the fact that there can be different levels of consolidation within a group and that the derogations according to Article 3 may only be applied at a lower (subconsolidated) level of consolidation (which can be the regional in contrast to the national level).

For example, Article 3 may be used to combine several local banks into a regional bank. As such, it allows a regional consolidating entity to hold a collective banking license with its permanent affiliated local institutions, provided that the four conditions set forth in Article 3 above are complied with, allowing the local affiliates to be exempted from prudential requirements. In this case, the regional bank including all of its local affiliated institutions are regarded as a single entity for the application of prudential regulations.

In the said example, if each regional bank fulfills prudential requirements referred to in Article 3 of the CRD on an individual basis, regional banks may then additionally be consolidated under a central organization which can be located at the national level. However, while a regional bank and its local affiliates benefit from the special prudential regime set out in Article 3, this may not be the case between the central top organization at the national level and the regional banks affiliated to it, which already satisfies the prudential requirements of the CRD on a solo basis.

b) "Affiliation" without derogation

The term "affiliation" in Article 3 CRD has not been translated into the different national languages in a convergent manner. Moreover, even in the CRD "affiliated" is used in a different context as well[1]. By way of consequence, prudential legislation in different Member States does not use the term "affiliation" in the same way, but in rather different ways:

- In some Member States, "affiliation" and its national translation imply a very specific relationship between institutions which is only used in the context of Article 3. While there may also be other institutions associated to the group, only those institutions, which are applying the derogations under Article 3, are considered as "affiliated".

- In other Member States the term "affiliation" is used to describe any relationship and thus includes any member of the co-operative group. It therefore also includes those affiliated institutions, which fulfill all the requirements of Article 3, and do not to make use of the derogations stipulated in Article 3. Instead, they fulfill the prudential requirements on an individual basis and they are supervised on a solo basis.

As regards these different kinds of relationships to the group the scope of the guidelines should be clarified. We think that such clarification is important to avoid any possible misunderstandings, in particular regarding:

- the scope of application (affiliated institutions versus institutions belonging to the group in another way than described under Article 3);
- the powers and instructions of the central body according to these guidelines and
- the European Passport

We therefore suggest to:

1. Change the heading above par. 5 to "Objectives, scope and methodology".
2. Introduce a new paragraph 7 and change the numbers of following paragraphs accordingly:

7: "CEBS is aware that there may also be institutions affiliated to groups, which may not fulfil the requirements of Article 3 or which fulfil those requirements, and do not apply for derogations of Article 3. If institutions do not make use of the derogations under Article 3 and are supervised on a solo basis, they do not fall within the scope of these guidelines"

Such institutions are therefore amongst others not subject to instructions that the management of the central body can issue (as described under par. [28] of CP 41) and can make use of their own EU-Passport without in any way being subject to the specifications of these guidelines on the EU-Passport (as described in par. [29]of CP 41)."

[1] See Annex VIII CRD: Credit Risk Mitigation, Part 1, Nr. 20

In addition, in order to further clarify the scope of the guidelines, we suggest modifying para. 10 as follows:

> *"10. CEBS believes that, for the convergent application of Article 3, further guidance is necessary on the following aspects in respect of the affiliated institutions that apply the derogations provided by Article 3 and are not supervised on an individual basis:"*

In case CEBS will not take these proposals into account, we suggest adding additional text on the concept of affiliation in CP41 to avoid possible misunderstandings. This is further explained under point 7 "Type of Instructions" and point 8 "EU Passport" of this position paper under the sub heading 'The notion of affiliation'.

3. ***Permanently affiliated***

We agree that it is necessary to have a common understanding of the concept of 'permanently affiliated' in order to clarify what the overarching aim of a group is: the stability of the whole group and enabling the group to fulfill its obligations vis-à-vis its creditors.

- Substance of affiliation

Furthermore, we appreciate that CEBS does not only refer to the prudential aspect of the concept of 'permanent affiliation' but also takes into account that the substance of affiliation in practice encompasses much more elements and arrangements and may be rather complex as referred to in para. 13 of CP 41.

The elements are the strings which create a lasting relationship between the central institution and all affiliates and which make leaving/exiting the group very difficult and costly. However, by no means should these illustrations and examples be understood as additional prudential requirements or necessary conditions falling under the concept of 'permanent affiliation'

- Final assessment on exit

As regards para. 17 of CP 41, we agree that in the event that an affiliate wishes to leave the group, the Supervisory Authorities have to ensure that there are no material negative consequences for both the exiting affiliate and the whole (remaining) group taking into account the internal decisions of the group.

Finally, we appreciate that a reference is made in the brackets to Article 6 CRD for all the prudential requirements the exiting affiliate shall have to comply with on a stand alone basis. For clarification however, we would suggest to indicate that it concerns Article 6 of the CRD i.e. Directive 2006/48/EC et seq. in order to avoid possible confusion.

4. Guarantee

We appreciate that CEBS allows for the acknowledgement of the different possible guarantee systems that can be considered under paragraph (a) of Article 3(1) in a descriptive manner.

Furthermore, as for para. 19 we agree that one condition set out in Article 3 should be kept in mind: the stability of the group and the need to create one joint capital against the creditors of the group by stating that the guarantee systems should ensure that there are no impediments to the prompt transfer of own funds. However, the details of these arrangements depend on the type of guarantee.

We would like to add however that guarantees de facto do not only result from formal guarantee arrangements but also from legal provisions or other contractual arrangements. We would suggest adding a footnote to clarify this issue. The text of this footnote would read as follows: 'This includes any arrangements providing that the entire assets of the central body and the affiliated institutions as a whole are available for the payments of obligations versus (the totality of) creditors of such central body and affiliated institutions as a whole'.

In para. 20 of CP 41, we consider that the guidelines are formulated in an appropriate manner with respect to the issue of the liabilities and commitments after the exit in order to meet divergences in the different Member States, especially by mentioning 'in accordance with the applicable guarantee system, applicable law and/or Articles of Association'.

5. Relation of requirements and exemptions

The EACB appreciates the clarifications as regards the requirements and exemptions under Article 3 especially after the modification of Article 3 by CRD II.

6. Consolidated Accounts

EACB agrees that the requirement for monitoring of solvency and liquidity on the basis of consolidated accounts should be seen from a prudential supervision's perspective only. The referral to the relevant provisions of the CRD and that "The assessment as to whether the central body must prepare consolidated financial accounts (and any relevant decisions or choices) should be performed on the basis of the accounting framework to which it is subject to under Regulation n° 1606/2002 of 19 July 2002 on the application of international accounting standards or Directive 86/635/EEC" is useful and appropriate.

7. Types of Instructions

- General

EACB considers that it should be noted, that due to the democratic structure of co-operatives, the terms of affiliation and the local affiliates' ownership of the central institution, the ***definition*** of policies may not be exclusively the competence of the central body. This may even be agreed jointly between the central body and affiliates, according to the specific rules in the governance structure of a group.

However, once agreed, the central body will have the powers to ensure the ***implementation*** of and adherence to these policies. In this respect we agree with para. 25 of CP 41. As according to Principle 1 of the Basel Committee's 'Enhancing corporate governance principles for banking organisations' of 2006[2], it is normally the Board of Directors that has the overall responsibility for the bank which includes approving and overseeing the implementation of the bank's strategic objectives risk strategy, corporate governance and corporate values. These fundamentals should be distinguished from instructions in current and daily operational business.

Therefore, EACB requests for a clear indication that the list under para. 28 of CP 41 is a list of non-exhaustive examples and not a list of 'minimum' requirements.

With regard to the above-mentioned reasons, the members of the EACB think that the term "defining" in the context of some subpoints under para. 28 of CP 41 goes too far and beyond the mere interpretation of Article 3 and suggest replacing it with *'monitoring of the implementation of'*.

- Specific aspects

We consider that the wording in subpoint 4 of para. 28 of CP 41 on 'defining the policy and principles of risk evaluation, measurement and control procedures' in the fifth line, stating "the same as the Central body's" is misleading and should be changed. Even though the strategy and policy of the affiliated institutions should be in conformity with risk management principles applicable to the group, these are not and cannot be exactly the same. Each of the affiliated institutions is subject to and affected by different geographical and market parameters, and other factors relating to the particular characteristics of the affiliate. Therefore, we suggest to change the last part of the sentence to read as *"the policy and strategic purpose of each affiliated institution is in conformity with the Group's risk appetite, capacity and also overall objectives of the Group"*.

Furthermore, concerning subpoint 7 of para. 28 of CP 41 on defining the criteria or rules for the fit and properness assessment of the persons effectively directing the business, we agree with requirements for the persons mentioned in Article 11(1) of the CRD. The added last part "as well as the other members of their senior management;" is unnecessary and not provided for by the CRD. Such reference to the whole senior management may even complicate matters. Article 11(1) CRD refers to the level of the persons assessed by supervisors in case new directors/board members are appointed for a registered credit institution which fully complies with all prudential requirements on a solo level. From a legal point of view, the current scope of the said Article 11(1) should not be widened by these CEBS guidelines. Moreover, this added part may require a large part of the senior managers of cooperative banks, which are large in number, to be subject to such a fit and proper test which is not realistic and may impede the competitive position of cooperative banks. In France for example, the number of directors in Credit Mutuel is approximately 24 000.

- The notion of affiliation

As we have explained under 2 b of this Position Paper, there may be a different understanding of "affiliation". In this paragraph we use the term 'affiliation' only in the

[2] Basel Committee on Banking Supervision, 2006. Enhancing corporate governance principles for banking organisations. Online available at: http://www.bis.org/publ/bcbs122.pdf.

context of Article 3 for those institutions which apply the derogations under this Article (see the new proposed para.7 and modified para. 10 under 2 b of this paper).

In case CEBS will not introduce a new para. 7 or modify para. 10, we suggest incorporating in para. 28 of CP 41 additional text clarifying that this applies to affiliated institutions that make use of the derogations under Art. 3 and are not supervised on an individual basis.

8. EU Passport

- Article 69(1) CRD

The situation and derogations in Article 3 are similar to those set forth in Article 69(1) CRD. Especially, in both Articles, solvency requirements need to be fulfilled on a consolidated basis only. Accordingly, these situations falling under these articles should be treated in the same way. In para. 6 of CP 41 CEBS even states that: *"It is CEBS's understanding that the main purpose of Article 3 is to clarify that the central body and its affiliates form a unity and thus to ensure, where appropriate, equal treatment of Groups as defined in this Article vis a vis credit institutions with a (vast) number of branches."* There are no restrictions whatsoever in Article 69(1) CRD as regards the EU passport for banks that are daughter companies. We therefore think that CEBS should not limit the possibilities of affiliated institutions under Article 3 in this respect either.

- Freedom of services and freedom of establishment

When discussing any options for affiliated institutions regarding cross-border activities and the EU passport, it seems necessary to distinguish between

a) the freedom to provide services (Article 28) and,
b) the freedom of establishment (Article 25 CRD) as referred to in Title III CRD and CEBS Guidelines for Passport Notification of 11 February 2009.

In fact, such differentiation is supported by the fact that the notification requirements for *freedom to provide services* and the *freedom of establishment* are different from those referred to in Article 25, Title III CRD and the CEBS Guidelines for Passport Notification of 11 February 2009.

- Freedom of services

The *freedom to provide services* is addressed in Article 28 CRD, which stipulates that 'any credit institution wishing to exercise the freedom to provide services by carrying on its activities within the territory or another Member State for the first time shall notify the competent authorities of the home Member State of the activities on the list in Annex 1 which it intends to carry on".

We think given the high integration of the internal market regarding the freedom of services (especially payments, internet banking), any distinction between servicing customers outside borders of the national Member State is extremely difficult to make, especially in retail banking. It therefore seems inappropriate to exclude affiliated institutions from servicing customers cross-border. Any such limitation would most

probably require significant reorganization, which is neither in the interest of the bank, the customer nor the supervisors. Clients would then be serviced by two banks, being the affiliated bank for the national activities and the central body for the international activities which is organizationally and commercially not in the interest of the client. This will also lead to an inequality between cooperative banks and banks on a corporate basis, which have dependant branches.

Moreover, direct involvement of the central body with retail customers is rather an exception. Retail activities are the core business of the affiliated banks, which accordingly dispose of the relevant knowledge and infrastructure. It is not the core business of the central body, which is rather executing a coordinating role in this respect. And servicing will take place where the client is. This is in fact also the case with banks on a corporate basis with dependant branches where the factual treatment and accompaniment of clients also takes place from the local branch near the client; but will this formally be regarded as been done by the one bank. There should be no disadvantage for affiliated banks in a co-operative group and therefore we think there should be no limits for the affiliated institutions under Article 3 regarding the freedom of services.

Furthermore, we would like to recall that Article 22 CRD requires banks to establish proper and robust governance requirements. It seems evident that it is of particular relevance for any form of cross-border activities, especially for groups described under Article 3. As such Article 22 CRD gives a sufficient appropriate tool to ensure that a) cross-border activities meet any prudential requirements and b) ensure the appropriate functioning of corporate governance.

As a group and subject to the strict control following from Article 3 and the provisions of both the regular requirements form the CRD and the internal governance and control arrangements, cooperative banks meet all standards the CRD requires and which are supervised by the supervisors.

Finally, there is the notification procedure under Article 28 CRD and in the CEBS Guidelines for Passport Notification of 11 February 2009, whose purpose is twofold. Firstly, the home country supervisor is notified that a credit institution envisages launching activities in another EU country. The home supervisor can/should take into account these activities when it defines its supervision programme. Secondly, the home supervisor informs the host supervisor/supervisor in the country in which services are rendered that activities will be launched in the said country. Thus, supervisors will be sufficiently informed about those activities of a group of banks under Article 3.

We therefore think that affiliated institutions should not be limited regarding the freedom to provide services. Notification by an individual affiliated bank or through the central body should both be allowed.

- <u>Freedom of establishment</u>

The notification requirements for *freedom of establishment* referred to in Article 25 CRD and the CEBS Guidelines for Passport Notification of 11 February 2009 are different from those under Article 28 CRD. Of course the opening of a branch or subsidiary may be seen differently considering the risks and magnitude of the business involved.

However, when it comes to the European passport, we think that CEBS should not focus on the formal argument that affiliated institutions do not fulfill solvency requirements on an individual basis. As indicated above, such approach would not be in accordance with

the aim and function of Article 3 and put co-operative groups at a disadvantage vis-à-vis groups under Article 69(1) CRD.

Instead, the focus should be on proper and robust governance requirements as stated in Article 22 CRD. This includes 'a clear organizational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and adequate internal control mechanisms, including sound administrative and accounting procedures'. Furthermore, the arrangements, processes and mechanisms mentioned shall be comprehensive and proportionate to the scale and complexity of the credit institutions activities. In addition, Article 22(2) CRD states that the technical criteria in Annex V of the CRD shall be taken into account. Annex V refers in addition to governance also to the different kinds of risk including liquidity risk.

Furthermore, Article 22 (2) CRD explicitly requires that *"the arrangements, processes and mechanisms referred to in paragraph 1 shall be comprehensive and proportionate to the nature, scale and complexity of the credit institution's activities."* We therefore think that in a group, which fulfills the requirements under Article 3, and which is treated as if it were one bank and especially disposes of a central solvency and liquidity management, should be prudentially treated equally vis-à-vis credit institutions with a vast number of branches. The crucial question is whether arrangements for branches meet the standards under Article 22 (2) CRD. Supervisors must have "no fear that things can go wrong". Thus, we think that Article 22 CRD already gives a sufficient appropriate tool to ensure that a) the opening of a branch or subsidiary meets any prudential requirements and b) the appropriate functioning of corporate governance.

Moreover, it has to be underlined that para. 28 of the CP 41 already includes instructions regarding "criteria or rules regarding the creation of new establishments". This also refers to cross-border establishments. Thus, the creation of any new trans-border establishment will never be and cannot be seen as an isolated activity of an affiliated institution. It is and has to be treated as an activity of the group as a whole, since it is based on/or in line with instructions of the central body. As we have already pointed out under 7 on 'Type of Instructions' of this Position Paper, the internal governance of co-operative groups typically implies the involvement of the affiliates or their representatives, when the central body defines such criteria or rules. Thus, the establishment of any cross-border establishment, as long as it is in line with internal governance rules of a group ***always*** is an act of the group as a whole.

Finally, notice should be taken of the fact that a central body very often acts as a coordinating and servicing entity, with limited banking activities, in particular in the area retail banking. It therefore may not make any sense to entrust the central body with the creation of cross-border establishments. It could make more sense to create an affiliated institution for the specific purpose of coordinating cross-border establishments. However, especially when cross-border activities are limited and related to specific (border) regions, it may be a better solution to run such activities by that affiliate that is geographically the closest.

We therefore think that the CEBS Guidelines for Passport Notification and the relevant Articles of CRD mentioned above are appropriate tools to ensure a proper organisation functioning and supervision of cross-border establishments by affiliated institutions. Provided that these rules are respected, affiliated institutions should be allowed to establish branches or subsidiaries in other EU countries.

- The notion of affiliation

As we have explained under 2 b of this Position Paper, there may be a different understanding of "affiliation". In this paragraph we use the term 'affiliation' only in the context of Article 3 for those institutions which apply the derogations under this Article (see the new proposed para.7 and modified para. 10 under 2 b of this paper).

In case CEBS will not take these proposals (referred to in 2 b of this paper) into account, we suggest adding additional text in para. [29] to CP41, clarifying that in certain member states there could exist (due to local regulations) affiliated institutions which do not make use of the derogations under Art. 3 and are supervised on a solo basis; they can make use of their own EU passport without in any way being subject to the specifications of these guidelines.