Resolution of conglomerates

Turning Policy into Reality

Eighth Pan-European Conglomerate Club

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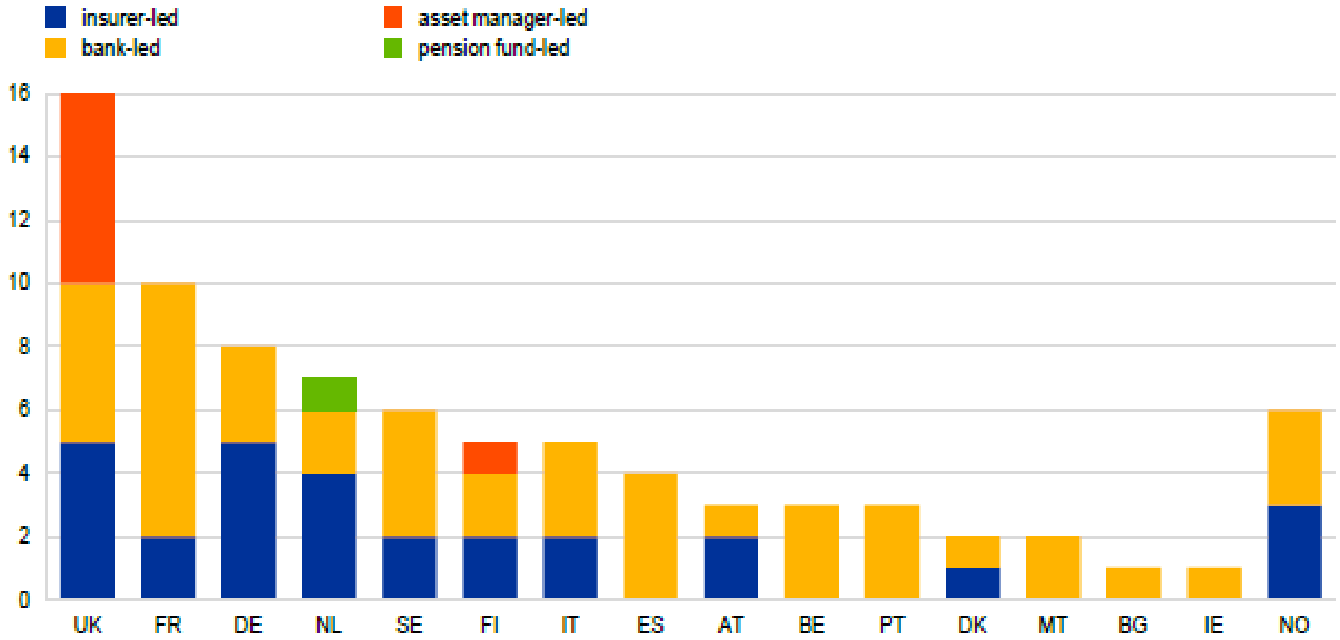
Frédéric VISNOVSKY Deputy Secretary General

Financial conglomerates: a reality in the EU

The 30 largest Financial conglomerates belong to the biggest financial groups in Europe

Number of financial conglomerates by type and domicile (2016)



Source: JC of ESAs (2016) and ESRB based on national data.
Note: Data for the UK also include four conglomerates with the head of group outside the EU/EEA.

Source: ESRB - Recovery and resolution for the EU insurance sector: a macro prudential perspective - August 2017

2. Resolution framework versus reality

Resolution framework for banks	Insurance and Systemic risks

The resolution objectives:

- Ensure the continuity of critical functions;
- Avoid significant adverse effects on financial stability, in particular by preventing contagion, including to market infrastructure, and by maintaining market discipline;
- Protect public funds by minimizing reliance on extraordinary public financial support;
- Protect depositors and investors;
- Protect client funds and client assets.

Conditions for resolution:

- The bank is failing or likely to fail;
- There is no reasonable prospect that any alternative private sector measure or supervisory action, including the write-down or conversion of capital instruments, would prevent the failure of the bank within a reasonable timeframe;
- A resolution action is necessary in the public interest.

Insurance activities may pose systemic risks:

(i) insurers amplifying shocks due to their involvement in so-called non-traditional and non-insurance activities;

(ii) insurers acting procyclically in terms of investment and pricing;

(iii) the collective failure of life insurers under a scenario of prolonged low risk-free rates and suddenly falling asset prices;

(iv) a lack of substitutes in certain classes of insurance vital to economic activity

Need to take into account

3. Resolution framework to be completed (1/2)

1. **No European resolution framework for conglomerates: scope of European legislation not considered insurance undertakings**

2. **Resolution of banks: still a long journey**

   - Strengthening the resolvability of banking groups by identifying impediments to resolvability and making banks address them

   - Operational capabilities and execution aspects of bank resolution strategies remain to be addressed

3. **Continuity and consistency is needed between supervision and resolution**

   - Need to increase **supervision of conglomerates** at the SSM: the SSM Supervisory Manual provides high level guidance for conducting supplementary supervision and is under review for update and inclusion of additional guidance

   - Need to develop analyses based on **uniform reporting**: existing draft ITS on intragroup transactions and risk concentration + work on capital adequacy reporting is ongoing (JCFC's TF on FICO reporting)

3. Resolution framework to be completed (2/2)

4. Need to implement resolution powers for insurance in countries with a legal framework (e.g. NL and FR) with several challenges

- In France, there are some limits to the resolution powers:
  - There is **no bail in tool** due to the existence of legal uncertainties (related to the FR property right). An EU directive could facilitate the introduction of the bail-in powers (primacy of the law of the European Union over the law of the Member States).
  - **No resolution funding arrangements** (private with ex ante resources or public) in spite of the existence of 2 schemes in France to protect policyholders (but not designed to provide resolution funding). This situation could make the capitalization of a bridge institution challenging.
  - When taking a resolution decision, the insurer concerned must still be **balance sheet solvent** (net assets positive), which restricts the number of cases and limits the timeframe if an insurer becomes balance sheet insolvent, the framework leads to liquidation and resolution would no longer be applicable.
- Work still in progress on the recovery plans and analysis of critical functions for insurers

4. Resolution of conglomerates: need to have (1/4)

Resolution planning for banks

- Adequately detailed overview of institution
- Main subsidiaries, critical functions, interconnectedness

Relevant for conglomerates

An effective resolution of a financial conglomerate should consider the structure of the conglomerate:

- Holding model (with banking and insurance activities as same-level subsidiaries);
- Bank-insurance model (banking holding company with insurance subsidiaries);
- Insurance-bank model.

What should be the scope of the resolution group?

- The business model of the conglomerate and the importance of insurance activities for the group (identification of core business lines);
- The interdependencies existing between the banking and insurance activities and their separability;
- The public interest assessment (including the assessment of the criticality of insurance activities and of the impact of their discontinuance on the financial system and the real economy).

4. Resolution of conglomerates: need to have (2/4)

Resolution planning for banks

- How the institution or group should be resolved
- Implementation plans for financial and business restructuring, funding and liquidity requirements

Relevant for conglomerates

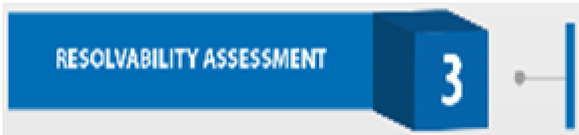
Banks: under SRB responsibilities / Insurances: under national authorities

- Duality of competences can create complexity: there is a legal framework determining the recovery and resolution powers available to National authorities to solve problems in insurance undertakings, while under the BRRD and the SRMR, the SRB is the primary resolution authority for the main credit institutions in the Banking Union.
- Coordination appears necessary considering this duality and may raise some challenges due to separated remits of powers that apply for common financial conglomerates: role to play by the relevant resolution colleges and CMGs.

What could be the value of the insurance which is dependent of the banking group?
What fees for the banking group after resolution in the event of the transfer of the insurance subsidiary?

4. Resolution of conglomerates: need to have (3/4)

Resolution planning for banks



- Identification of impediments to resolvability
- Measures to address or remove these impediments

Relevant for conglomerates

Separability between banking and insurance entities?

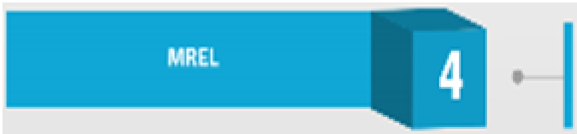
- **Financial interdependencies** under various forms: capital, funding or liquidity arrangements, credit exposures, cross-guarantee agreements or cross-collateral arrangements.
- **Commercial and organizational interdependencies:** distribution of insurance products through the retail network of the banking group and management of the insurers' investments by the asset manager of the banking group (payment of corresponding fees by the insurance undertaking)
- **Operational interdependencies**: common or shared staff, facilities and systems.
- **Reputational interdependencies**: interconnected trademarks.

A lack of separability between banking and insurance could be an impediment to resolvability of the banking group:

- Continuity of critical functions
- Avoidance of a significant adverse effect on the financial system

4. Resolution of conglomerates: need to have (4/4)

Resolution planning for banks



- ➢ Adequate level of loss absorption capacities: Minimum Requirement of own Funds and Eligible Liabilities

Relevant for conglomerates

Current MREL calculation captures the risks inherent in bank-insurance groups

- ➢ Insurance risks are computed in the RWA which are the basis of MREL calculation
- ➢ MREL instruments subscribed (directly or indirectly) by the insurance subsidiaries do not qualify as eligible liabilities instruments the banks

Ensuring loss absorption capacity is available at the right level

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