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EAPB Position Paper on the

prudential treatment of certain exposures to Promotional Banks under Solvency II

Context & General Remarks

On 30 September 2015, the Commission launched its Action Plan on Building a Capital Markets Union (CMU). One of the aims of the Action Plan is to incentivize investments of insurance companies into certain asset classes. The European Association of Public Banks (EAPB) welcomes this initiative and in this regard proposes to introduce a preferential treatment under Solvency II regarding exposures to Promotional Banks (PBs) which are fully, unconditionally and irrevocably guaranteed by regional governments. In the context of the Action Plan's six different rubrics our suggestion primarily relates to "The Path to Growth — Financing For Innovation, Start-ups and Non-Listed Companies" and "Investing For The Long Term, Infrastructure And Sustainable Investment".

Selected Goals included in the Action Plan on Building a Capital Markets Union

The Path to Growth — Financing For Innovation, Start-Ups And Non-Listed Companies

One of the Commission's main aims is to better support small and medium-sized businesses through the establishment of a CMU. In particular, the Commission emphasizes the significance of start-up companies as instigators of growth for the economy. In order to realize their promising business ideas, these newly founded companies need access to attractive financing options, especially with regard to building up equity capital. In this context Europe's potential is still relatively unexploited which can have negative effects on economic development.

Investing For The Long Term, Infrastructure And Sustainable Investment

The Commission also intends to create an appropriate legal framework for long-term, sustainable investments. To increase its competitiveness, Europe needs

Avenue de la Joyeuse Entrée 1 – 5, B-1040 Brussels •Phone : +32 /2 / 286 90 68 •Fax : +32 /2 / 231 03 47
Website : www.eapb.eu, Register ID: 8754829960-32
Contact: roman.hametner@eapb.eu

extensive long-term investments in the development of its infrastructure. Although the Commission is providing significant means on its own, it points out that its investment campaign must be accompanied by other measures in order to mobilize additional capital for investments in the long term. Banks and PBs often procure such capital primarily from large institutional investors, insurance companies or pension funds. The regulatory framework plays a significant role in attracting these investors.

The role of the banking industry

The Commission acknowledges that banks have a central role in the CMU due to their strong local ties. Bank financing will insofar remain an important source of finance for many companies. At the same time it is still important for the Commission that other institutional investors, such as life insurance companies or pension funds, can be used as a source of finance even for banks. However, it seems that such investors have reduced their investments in recent years. By calibrating the own funds requirements under Solvency II, the prudential framework can improve the interests of institutional investors in particular investment classes.

The essence and mandate of PBs

PBs are playing a crucial role in public finance. PBs are obliged to pursue the socio-political goals of the respective public owners (state or regional government). They provide banking services in market segments where the services of private market participants are not enough to attain sufficient results. Generally, the tasks of PBs are often laid down in federal law, state law or regulations. These rules constitute the basis for their tasks with regard to regional promotion of small and medium-sized enterprises, the residential real estate sector, as well as infrastructure.

A major part of the financial services which are provided by PBs are long-term loans, partly with discounted interest rates. In agreement with their public owners, they develop programs to cover the risks associated with start-up companies in the form of indemnities and guarantees. Further, PBs provide means of equity financing. The aims of PBs are therefore very much in line with the declared goals of the Action Plan.

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Detailed Remarks

Problem: Provisions in Solvency II put certain exposures to PBs at a disadvantage

In many cases, PBs make use of public monies from Member State- or EU-sources, in order to be able to offer targeted development programs. In this context, they can be dependent on refinancing via the capital markets. In some cases, the respective financial instruments are guaranteed by regional governments. We are concerned that there will be impediments for these important refinancing instruments in the near future, due to a rather unclear and unfavorable prudential treatment under the current version of Solvency II. To be specific, our concerns relate to the alleged capital requirements for the aforementioned exposures which seem to be unreasonably high considering the fact that PBs and their publicly responsible bodies enjoy the highest possible credit rating for long-term obligations.

Suggested solution: Alignment of the regulatory treatment for banks and insurance companies regarding exposures which are guaranteed by regional governments

In its Action Plan, the Commission expresses several times that it wants to examine the regulatory framework regarding own funds requirements for insurance companies with a focus on mobilizing additional investments from the insurance sector and from other institutional and private investors. For PBs and the fulfilment of their tasks, it is of utmost importance that exposures to them which are fully, unconditionally and irrevocably guaranteed by regional governments can benefit from an attractive regulatory framework under Solvency II, as a favorable prudential treatment is decisive for the attraction of potential investors.

Prudential framework for banks

According to Art. 115 (2) CRR, exposures to regional governments or local authorities can be treated like exposures to their central government. Additionally, risk positions towards PBs can be treated in the same way as comparable risk positions towards the regional governments in which they are located, according to Art. 116 (4) CRR.

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Request

We ask the Commission to ensure that exposures to PBs which are fully, unconditionally and irrevocably guaranteed by regional governments, are assigned with a stress$_i$ risk factor of 0% under the Solvency II–regime, if there is no difference in risk between the exposures of the regional governments and exposures of the central government (see Art. 85 of Delegated Regulation (EU) Nr. 2015/35) and if the guarantee fulfils the requirements of Art. 215 of the Delegated Regulation (EU) Nr. 2015/35.

In other words, this would mean that the prudential treatment of such exposures under the prudential framework for insurance companies would be aligned with the treatment under the prudential framework for banks.

Reasoning

In our opinion, risk exposures to central governments on the basis of Art. 180 (2) lit. b of Delegated Regulation (EU) Nr. 2015/35 are assigned a stress$_i$ risk factor of 0%. Further, Art. 1 of EIOPA/CP/14/057 stipulates that certain regional governments fulfil the requirements of Art. 109a (2) lit. a of the Solvency II–Directive together with Art. 85 of Delegated Regulation (EU) Nr. 2015/35. This means that risk exposures to the named regional governments can also be assigned a stress$_i$ risk factor of 0%.

For certain PBs the legal framework stipulates that there are direct guarantees from the respective regional governments for exposures to them. Due to their full, unconditional and irrevocable nature, these guarantees fulfil the requirements of Art. 215 of Delegated Regulation (EU) Nr. 2015/35. Therefore, in analogy to the existence of a full, unconditional and irrevocable guarantee of a central government, risk exposures with guarantees from regional governments for whom the default risk has not been determined to be different from the applicable central government according to Art. 85 of Delegated Regulation (EU) Nr. 2015/35, a stress$_i$ risk factor of 0% should be assigned. This means that Art. 180 (2) lit. b of Delegated Regulation (EU) Nr. 2015/35 should also be applied to such counterparts whose default risk has not been determined to be different when compared to the central government according to Art. 85 of Delegated Regulation (EU) Nr. 2015/35.

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About EAPB

The European Association of Public Banks (EAPB) represents the interests of 31 public banks, funding agencies and associations of public banks throughout Europe, which together represent some 93 public financial institutions. The latter have a combined balance sheet total of about EUR 3,500 billion and represent about 190,000 employees, i.e. covering a European market share of approximately 15%.

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