

Proposed EU regulation on bank structure – impact on insurance business

The proposed EU regulation on bank structure (BSR) could have a significant impact on the insurance business of some banking groups that include an insurance company and even on some insurance groups that include an EU bank. In particular, the European Commission's proposed text for the BSR would ban any entity in a group within the scope of the regulation from own account investment in financial instruments and alternative investment funds (AIFs), subject to limited exceptions that do not recognise the special nature of the investment activities of insurance companies.

In January 2014, the European Commission submitted a legislative proposal for the BSR, which is still under consideration by the Council and the European Parliament. The main objectives of the BSR are to prohibit proprietary trading and related activities in large groups containing banks and to require certain banks in such groups to separate their trading activities from their other activities. The BSR, and in particular the proposed ban on proprietary trading and investment in AIFs, could have a significant adverse impact on groups that contain both an EU bank and an EU or non-EU insurance company.

The proposed BSR would apply to, amongst others:

- Banking groups with an EU parent company identified as a globally systemically important institution (G-SIIs) under the EU Capital Requirements Directive.

- Other groups or sub-groups headed by an EU parent company which include an EU credit institution if the group's or sub-group's total assets are at least €30 billion and its "trading activities" are at least €70 billion or 10% of its total assets.

Trading activities are calculated by averaging the short term positions in securities and non-hedging derivatives assets and liabilities of all the entities in the relevant group. Assets and liabilities of insurance and reinsurance undertakings and other non-financial undertakings are not included when calculating total assets and trading activities.

A number of G-SII or other banking groups that meet the tests set out above will include an EU or non-EU insurance subsidiary. In addition, many insurance groups headed by an EU parent include an EU bank and may have total assets of at least €30 billion even excluding the assets

and liabilities of their insurance companies and other non-financial undertakings. They will have to be able to calculate on an ongoing basis whether their worldwide non-insurance financial undertakings have "trading activities" amounting to at least €70 billion or 10% of the group's total assets, to ensure that they do not become subject to the requirements of the BSR.

Under the Commission's proposal, where a group falls within its scope, the proposed BSR would prohibit every EU or non-EU member of the group:

- Engaging in proprietary trading, defined as taking positions in transactions to acquire or dispose of any financial instrument or commodity for the sole purpose of making a profit for own account unless it is connected to actual or anticipated client activity (or hedging risk resulting from that

client activity) or is not through use of dedicated desks, units, divisions or individual traders dedicated to such dealing (subject to very limited exceptions for investments in EU government bonds and cash equivalent assets).

- For the sole purpose of making a profit for own account, acquiring or retaining any shares or units in Alternative Investment Funds (AIFs) or investing in derivatives linked to such shares or units (subject to limited exceptions for certain types of funds).
- For the sole purpose of making a profit for own account, holding any units or shares in an entity that engages in proprietary trading or acquires units or shares in AIFs.

Unlike the analogous Volcker Rule in the US, there is no exception for the investment activities of regulated insurance companies which invest premium and investment income for own account in financial instruments (as well as in AIFs).

Therefore, under the Commission's proposal, groups that fall within the scope of the BSR may have to choose between disposing of either their insurance or their bank entities to ensure that this prohibition does not apply to the insurance companies in the group.

In addition, where a group falls within its scope, the proposed BSR would require any core credit institution in the group (i.e. an EU bank that takes deposits eligible for deposit insurance) to be reviewed against certain metrics to determine whether it should be subject to requirements to separate its trading activities from its other activities.

The BSR is controversial for reasons unconnected with the treatment of insurance companies and discussions in the Parliament and the Council have not so far focused on the issues presented for insurance business. However, there are proposals under consideration in the Council working group that would limit the application of the prohibitions on proprietary

trading and investment in AIFs to certain core credit institutions in a group within the scope of the BSR, so long as other group entities within the scope of the regulation that conduct activities that would otherwise be prohibited are separated from the core credit institution. If these proposals were accepted by the Parliament and reflected in the final text of the BSR, they could reduce the impact of the regulation on insurance companies within larger groups (although there may be uncertainties about the degree of separation required in order to comply with the proposed rule).

Nevertheless, additional amendments would still be needed to address the burden that the proposed BSR could place on large insurance groups that own relatively small EU banks, as they would still be required to carry out the complex ongoing threshold calculations required to determine whether they are within the scope of the BSR and, if in scope, to subject their banking subsidiary to the process for the separation of activities.

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