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Subject: Response of Crédit Agricole S.A. to the Joint Forum's consultation on its Principles for the supervision of financial conglomerates.

Crédit Agricole SA welcomes the opportunity to comment on the Joint Forum's consultative paper on *Principles for the supervision of financial conglomerates*. We fully support the explicit recognition of financial conglomerates and acknowledge the decision of regulators to review the 1999 principles.

From a European perspective, it is worth recalling that, the European Union has developed, already since 2002, a robust financial conglomerate prudential framework providing for a sound development and oversight of the "bank-insurance" model (Directive 2002/87/EC). This legislation has been updated in December 2011 and many issues raised in the Joint Forum's consultative paper are already carefully addressed therein.

In this context, we believe that **the priority for regulators should lie first and foremost in the effective implementation of the Basel 3/CRD4 rules for banks and, at the European level, Solvency 2 for insurance companies**. Any evolution in the international financial conglomerates supervision framework should refrain from disrupting the complex implementation of these two sectorial prudential frameworks.

Furthermore, any revision of the prudential framework for financial conglomerates should duly take into account the specificities of those institutions (internal organization, risk management, supervision, etc.) and recognize the benefits they bring to the economy:

- Diversified and well-adapted financial products and services for consumers: financial conglomerates provide a wide range of well-suited products and services to their clients and do so on the basis of competitive pricing strategies (cost mutualisation effects through distribution networks).
- Risk diversification and investment opportunities for clients.
- Financial stability: financial conglomerates play an important role as financial stabilizers and economic shock absorbers, in particular when their activities are focused on retail customers.

You will find attached our detailed comments on the consultative paper. We wish, however, to emphasize the three key issues we believe should carefully be addressed when reviewing the existing prudential framework for financial conglomerates:

- Preserving financial conglomerates' successful and sound integrated business model;
- Recognizing the diversification benefits stemming from the bank insurance model;
- Ensuring sufficient flexibility in order to effectively manage financial conglomerates' capital.

Please kindly note that Crédit Agricole S.A., also fully endorses the response submitted by the French Banking Federation (FBF) and the International Banking Federation (IBFed).

We trust the Joint Forum will find these comments helpful for its work and look forward to continue the dialogue with regulators and policy-makers on this important subject.

Yours faithfully,

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JOINT FORUM'S CONSULTATION ON PRINCIPLES FOR THE SUPERVISIONT OF FINANCIAL CONGLOMERATES

- Crédit Agricole S.A. response -

The Group Crédit Agricole S.A. is a leading international banking and insurance group. Its Tier 1 ratio is 11.2%. It is present in more than 30 countries worldwide and servicing more than 54 million customers through a network of 11,600 branches solidly anchored in their territories. The Group employs 160.000 people worldwide and offers a wide range of financial services, including retail banking, insurance, consumer finance, asset management, private banking, leasing, factoring and corporate and investment banking.

The Group Crédit Agricole S.A. intends to fulfill its role as a leading European player with global scale, while complying with the commitments that stem from its mutualist background. It focuses its development on servicing the real economy and is committed to the principle of responsible growth.

Crédit Agricole S.A. welcomes the publication of the Joint Forum's consultative paper on *Principles for the supervision of financial conglomerates* and the opportunity to comment on it. We fully support the explicit recognition of financial conglomerates and acknowledge the decision of regulators to review the 1999 principles.

With this in mind, it is worth recalling that, the European Union has developed, already since 2002, a robust financial conglomerate prudential framework providing for a sound development and oversight of the "bank-insurance" model (Directive 2002/87/EC). This legislation has been updated in December 2011 and many issues raised in the Joint Forum's consultative paper are already carefully addressed therein.

In this context, we believe that **the priority for regulators should lie first and foremost in the effective implementation of the Basel 3/CRD4 rules for banks and, at the European level, Solvency 2 for insurance companies**. Any evolution in the international financial conglomerates supervision framework should refrain from disrupting the complex implementation of these two sectorial prudential regulations.

Furthermore, whilst we understand the desire of regulators to review the prudential framework of financial conglomerates, this should be done with due consideration to the specificities of these institutions (internal organisation, risk management, supervision, etc.). Any revision of the rules relating to conglomerates should also provide the flexibility that such groups need to deploy their full benefits to the economy. These, as we know, are multiple in the case of bank insurance activities:

- Diversified and well-adapted financial products and services for consumers: financial conglomerates provide a wide range of well-suited products and services to their clients and do so, on the basis of competitive pricing strategies (cost mutualisation effects through distribution networks).
- Risk diversification and investment opportunities for clients.
- Financial stability: financial conglomerates play an important role as financial stabilizers and economic shock absorbers, in particular when their activities are focused on retail customers.

Before turning to our specific comments on the proposed *Principles for the supervision of financial conglomerates*, we would like to recall the main strengths of the financial conglomerate model and summarise the key issues we believe should carefully be taken into consideration when reviewing the existing prudential framework for financial conglomerates. In a nutshell, these include the need to:

- Preserve financial conglomerates' successful and sound integrated business model;
- Recognize the diversification effects stemming from the bank insurance model;
- Ensure sufficient flexibility in order to effectively manage financial conglomerates' capital.

GENERAL COMMENTS:

1. Banking and insurance groups organized as financial conglomerates have developed a successful and sound integrated business model which should be preserved

- *Insurance products are an essential part of a banking group's diversity in terms of product range*

Substantial holdings in insurance companies enable banking groups to significantly enlarge the range of products they can offer to their customers, in a competitive environment, through a common distribution channel. They also provide an in-depth knowledge of the client portfolio which is a key factor for improving risk management.

Indeed, the bank insurance business model is based on synergies between banking and insurance activities: the group's insurance companies distribute their products through the bank branches. This creates a "win-win"

situation for the financial institution and its clients: customers get simple answers to all their financial needs at a single sale point while banks provide a large variety of products to a wide range of customers, regardless of their social or financial background. As a result, these groups can offer life insurance products adapted to all types of income, and which can be adjusted throughout the life of the contract.

Moreover, the integration of banking and insurance activities is an important factor of economic and financial stability. The "bank insurance" model contributes to the sound financing of the economy in two main ways:

1. By mitigating credit risk, insurance activities help provide banking loans with lower spread to a wide range of individuals and corporates (performance bonds, unemployment or asset damage coverage, etc.);
2. Insurance activities directly finance the economy on a long-term basis through investments in bonds and sometimes equity instruments to cover their liabilities (future claims for damages, life casualties, pension fund annuities, etc.).

- *Risks borne by insurance companies are of a different nature than those borne by banks*

The main types of risk facing insurers are (i) underwriting risks (insurers predict the likelihood that claims could arise from the protection they have sold and they price their products accordingly) and (ii) asset management risks (companies have to ensure that the premiums and life insurance or pension contract deposits that they receive are invested in an appropriate way). These risks cannot be assimilated to nor managed as banking risks. They must be assessed within a specific framework, which is the purpose of Solvency II at the European level.

- *Insurance is a stabilization factor for conglomerates and a shock-absorber for the economy*

The existence of an insurance "leg" within a banking conglomerate is an important stabilizing factor, one that should be preserved and even encouraged, especially in times of fragile and volatile economic activity. Indeed, banking and insurance activities operate on very different time horizons (very long-term for the insurance investments), so that the correlation between their economic and investment cycles, though positive, is quite low and provides an important diversification of risks.

In light of the recommendations made by the Committee of European Banking Supervisors (CEBS) on 2 September 2010 regarding the criteria for validating inter-risk diversification, the group Crédit Agricole has carried out two studies, using different methodologies, to demonstrate the reality of those diversification effects[1]:

- A study by market indices which analyses, between January 2005 and August 2010, the correlations between market indicators relating to risk. The data have been divided into 5 periods of time: peak of the cycle (Jan. 05 – Jun. 06), crisis' precursor (Jun. 06 – Jun. 07), subprime crisis (Jun. 07 – Dec. 08); banking crisis (Jul. 08 – Dec. 09); post crisis (Dec. 09 – Aug. 10). The insurance risk is correlated to 5 other types of risks: market, retail credit, non-retail credit, interest rate and equities. Risk factors are measured using historical market indices (ex:Forex, IBOXX, ITRAXX, Euribor,…), each index being allocated to a specific risk. The data retained as a reference in the following table are the maximum correlations found during the analysis (here, each time, corresponding to the post-crisis period).

- A study based on the analysis of the net income generated by each business line of the group in order to determine correlation coefficients: the same six risks are covered, each business line being allocated to the one of the risk categories, based on the predominant risk for each business line (for example, "retail credit" stands for both retail banking and consumer credit activities of the group). The internal data, considered for the period 2004-2009, shows that the bank/insurance diversification has significantly amortized the effects of the financial crisis that has particularly hit the group's investment bank.

[1] For further information on both studies, please refer to the document in Annex.

The results confirm the diversification effects stemming from the bank insurance model. In the table below, summarizing the results of both analyses, we can see that all correlation rates between the insurance risk and the 5 identified banking risks are lower than 100%: the lower is the percentage rate, the lower is the correlation between risks, and the higher are the diversification benefits.

		Correlation Insurance/Banking risks				
		Market	Retail credit	Non-retail credit	Interest rate	Equity
Insurance	By market indices	70%	29%	78%	57%	94%
	By income per business line	79%	41%	71%	N/A	50%

Altogether, we want to underline that the "bank insurance" model has been operational for many years and has proved its efficiency and resilience over time. In our view, rather than demonstrating the fragility of the financial conglomerate model offering a wide variety of products to retail customers, the current crisis has shown the limits of certain specialized actors ("pure players").

2. Flexibility is necessary for an effective capital management in financial conglomerates

Crédit Agricole supports a global supervisory oversight of financial conglomerates, through reinforced powers of the group-level supervisor, and the strengthening of cooperation, coordination and information exchange among supervisors within the college of supervisors. As a matter of fact, such a system has already been successfully implemented in France where banking and insurance activities are supervised by a unique supervisor. On this basis, we welcome the Joint Forum's proposal to use a "banking Pillar 2"-type approach for the supervision of financial conglomerates. Greater coherence between banking and insurance core principles for supervision would help financial conglomerates to achieve a more efficient risk management framework, whilst maintaining the specific "risk-structure" of each activity within the conglomerate.

As far as capital requirements are concerned, we support the conservation of the current approach of the European legislation which imposes capital requirements by risk type, based on confidence levels fixed at sectorial levels and which provides that the solvency assessment of a conglomerate is best performed through an effective supervision and a solvency test based on the regulatory capital requirements of both sectors. The solvency test is satisfied when the financial conglomerate, after eliminating intra-group transactions, has effectively more regulatory consolidated capital than the cumulative capital requirements resulting from both its banking activities and its insurance activities. Such an approach guarantees the sound risk management of the conglomerate, as well as the flexibility necessary to adjust to the cycles of each sectorial entity. Therefore, this method should be preferred to the implementation of an additional buffer of capital. In our view, regulators should refrain from imposing additional capital charges on top of these sectorial charges as this could entail inadequate consequences, such as, for example, the introduction of useless obstacles to capital circulation within financial conglomerates or the risk of double gearing of capital requirements.
Should this approach not be possible, any additional buffer should be implemented at the level of the financial conglomerate's dominant entity, rather than at the level of each of the sectorial entities.

Going one step further, we do not share the view suggested in the Joint Forum's consultation paper, that the risk of combined banking and insurance activities is greater than the sum of these two activities' standalone risks. Indeed, nothing in recent financial and economic developments supports this idea. On the contrary, we believe that the diversification benefits derived from risk aggregation within the context of a conglomerate

have been clearly demonstrated during the crisis and should therefore be recognized within the revision of the core principles for capital adequacy.

Finally, we believe it is essential that the difference of risks taken in the two business sectors be reflected by tailored sectorial prudential legislations, with well-adapted capital adequacy and solvency rules.

SPECIFIC REMARKS:

I & II. Supervisory powers and authority – supervisory responsibility

As mentioned earlier in Section 2 of this paper, we are in favour of a global supervisory oversight of financial conglomerates, through reinforced powers of the group-level supervisor, and the strengthening of cooperation, coordination and information exchange among supervisors, in order to render the group-wide supervision truly effective. Therefore, we generally support the Joint Forum's proposed principles as regard supervisory powers, authority and responsibility.

However, some principles could be clarified:

- **§ 5 – Group-level supervisor:**
    - the specific responsibilities of the group-level supervisor vis-à-vis the other supervisors of the college are not sufficiently elaborated. For example, we consider that the final say should be given to the group-level supervisor in case of diverging views among supervisors in the college on issues pertaining to financial conglomerate supervision.
    - The principles should insist on the need to develop a common supervisory language and culture, in order to facilitate communication within the college. It is particularly important in the case of bank-insurance conglomerates, where supervisors are in charge of very different businesses with are subject to different prudential rules.

- **§ 9 – Supervisory tools and enforcement:** as regard the "sanctions and corrective actions" provided for in paragraph 9.2, it should be clarified that such sanctions should only be used to address infringements or sources of risk specifically relating to financial conglomerates' supervision. They should not seek to address any potential sectorial issues.

III. Corporate governance

§ 11 - Structure of the financial conglomerate

We support the Joint Forum's principle of an easily understandable and transparent organisational and managerial structure of the group.

However, we contest **paragraph 11.b**. We are concerned with the use of the term *"appropriate circumstances",* which is unclear and too vague to ensure legal certainty. Moreover, if those "appropriate circumstances" refer to a situation in going concern, we object the possibility given to the group-level supervisor to influence the structure of a financial conglomerate. It would be a too far-reaching power which would enable the authorities to unjustifiably interfere in the governance of the company. At the European level, the CEBS has recognized as a general principle that supervisory authorities should "not interfere in an institution's strategy and the way it runs its business".

Furthermore, using these powers in an economically healthy institution may well trigger what it is trying to prevent by sending what may be interpreted as worrying signals to the markets. The risk of endangering the competitive and financial situation of the institution at stake would be relatively high.

As regard **paragraph 11.c**, we find questionable the requirement that board members should be capable of describing and understanding the purpose, structure, strategy, material operations and material risks of the financial conglomerate, including those of unregulated entities that are part of the financial conglomerate structure. This requirement appears to us as excessive as regards the duties and responsibilities of the board of directors. Indeed, whilst board members should be well aware of the group's main risk factors, they should also be able to rely on the senior management and the internal control functions of the company to get a more technical or detailed insight of the risks borne by the company.

IV. Capital adequacy and liquidity

§ 15 - Capital management requirements

We support the principles according to which financial conglomerates should manage their capital through a rigorous, board-approved, comprehensive and well documented process. However, it should be noted that the **requirements 15.e to 15.l regarding capital planning of financial conglomerates are far more detailed and prescriptive than those existing under any of the sectorial regulations** (eg. Basel 3, Solvency 2 in the EU).

While those requirements may be particularly relevant in certain circumstances (e.g. financial conglomerates significantly involved in non-life insurance and financial market activities) and in jurisdictions where there are no regulation applicable to financial conglomerates, they may be burdensome in the case of financial conglomerates with a lower risk profile focused on retail customers and/or already subject to a supplementary supervision - as it already the case in the EU.

Therefore, we recommend the introduction of the following principles:

- The application of the principle of proportionality for those requirements;
- An increased role of the group-level supervisor in identifying which requirements are relevant for each financial conglomerate under its supervision, in view of its risk profile and existing requirements applicable to the company at national level.

§ 16 - Capital adequacy assessment

First of all, we consider that unregulated entities and regulated entities' interactions with them should be taken into account as "environmental" factors as part of the Pillar 2 Supervisory Review and Evaluation Process (i.e. without strictly extending the regulation to unregulated entities).

As explained in our general comments, the group Crédit Agricole, does not support the introduction of a power for supervisors to apply a buffer in addition to the regulatory minima and targets (§ 16.d). However, should regulators decide to go ahead with this decision, the Joint Forum should clarify the specific circumstances under which, and the criteria according to which supervisors could require group-wide capital to exceed regulatory requirements. In particular, supervisors should take into account the already existing buffers at the level of both the banking and insurance activities prior to applying such requirements at the financial conglomerate level.

More broadly, the possible existence of a buffer of capital also raises the issue of its level of application within the group and of its uniqueness: are we talking about one buffer applied to the conglomerate's head or about multiple sectorial buffers? Should such a buffer be introduced, the group Crédit Agricole believes it would be more appropriate to apply it at the level of the conglomerate's head.

§ 17 – Consideration of double or multiple gearing

At the European level, the Financial Conglomerate directive already requires the calculation of supplementary capital adequacy requirements (§ 17.c). Through this supplementary supervision, the directive aims to control and prevent potential risks arising from double or multiple use of capital. Therefore, we suggest clarifying paragraph 17, with the following wording:
*“**When this is not required in the regulation applicable to financial conglomerates established in their jurisdictions,** supervisors should require that capital adequacy assessment and measurement techniques consider double or multiple gearing”.*

V. Risk management

§ 21 & § 22 – Risk management framework and culture

We support the proposed Joint Forum’s principles regarding risk management framework and culture. They are fully consistent with the high-level principles for risk management, produced by the CEBS (February 2010).

However, we suggest clarifying two specific issues:

- **§ 21.c**: We support this principle but a clarification should be introduced : “*Supervisors should require that the Board of Directors of the financial conglomerate has a direct reporting line with the risk function management **and, at its convenience, has the possibility to request the chief risk officer’s presence**.*” It is worth noting however that the risk management function should not be allowed to directly contact the board of directors: the information should flow in priority from the risk management function to the senior management who has the ability to pass it on to the board of directors.
- **§22.1:** We believe that the current wording of this principle is too strong, as it suggests that the board and the senior management are in charge of the concrete implementation of the risk management culture of the conglomerate. We propose to attenuate the wording in the following way: *“The standard for the risk management culture should be **under the responsibility of** the board and senior management of the financial conglomerate”.*

§ 25 – Outsourcing

The explanatory comment 25.3 provides that “certain functions within financial conglomerates” should not be outsourced. We oppose the view that a total ban is necessary and believe that outsourcing, of any of the financial conglomerate’s function, should be allowed as long as the institutions meets some specific requirements: the French regulation on internal control within banks (97.02) applies such a principle.
As a minimum, the functions referred to in this paragraph, as well as the reasons of the ban for their outsourcing, should be clearly stated.

§ 26 – Stress and scenario testing

We fully support the idea that stress testing and, more generally, scenario analyses are key tools to assess the risk profile of a financial institution, as well as to challenge its risk appetite.

However, in the context of financial conglomerates these exercises will come across practical limits due to the heterogeneity of the business models and natures of risk of the entities borne by the different institutions. As an example, the difference between the time horizons relevant to banks and insurance management would lead to add up figures calculated in a traditional silo approach, probably not relevant and far from a real integrated risk process (as it is the case with banks’ trading and banking books).

As regard the methodology, we acknowledge that it should rely on a group-wide approach, while also considering the results of sectorial stress tests (§ 26.d). In any case, the methodology should not be too

prescriptive as the diversity of financial conglomerates' risk profiles could not be captured by a "one size fits all" approach.

§ 27 - Risk aggregation

CEBS's position paper on the recognition of diversification benefits under Pillar 2 (September 2010) lists criteria as a prerequisite for the recognition of diversification. Based on these criteria, and as demonstrated earlier on in this paper, we think that insurance activities in financial conglomerates generate intra-group diversification due to their specific business models, risk profiles and operations in various geographies, markets and sectors. This diversification benefits, deriving from the aggregation of risks, should be recognized when considering capital adequacy and solvency purposes (part IV).

§ 28 - Risk concentrations and intra-group transactions and exposures

Public disclosure of risk concentrations is already provided for by Pillar 3 requirements of Basel 3 and Solvency 2.

As to intra-group transactions, we recognize that such information should be reported to the supervisors. However a public disclosure doesn't appear useful, and might even prove counter-productive in some cases.