Allianz SE

Allianz

www.allianz.com

Allianz, 80790 Munich, Germany

Koeniginstrasse 28
80802 Munich, Germany
Phone +49 89.38 00-0

Commerzbank AG
Bank code 700 800 00
Account No. 310 922 700
IBAN DE48 7008 0000 0310 9227 00
SWIFT-BIC DRESDEFF700

European Securities and Markets Authority (ESMA),
European Banking Authority (EBA),
European Insurance and Occupational Pensions Authority (EIOPA),
Joint Committee of the European Supervisory Authorities

Your ref.:

Direct dial
Tel. +49 89 38 00-18132
Fax +49 89 38 00-2152
Mail adrian.glaesner@allianz.com

Our ref., Date
Dr. Adrian Glaesner
14.07.2014

**Re: Response to the Consultation Paper regarding draft regulatory technical standards on risk-mitigation techniques for OTC-derivate contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012**

Dear Sir or Madam,

Allianz welcomes the opportunity to respond to the Consultation Paper regarding the draft regulatory technical standards on risk-mitigation techniques for OTC-derivate contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012 (hereinafter referred to as "**CP**").

We have focused our response on specific key themes in the CP, in particular on the procedures and exemptions concerning intragroup derivative transactions. Allianz endorses the ESAs´ aim to ensure that the criteria for granting an exemption from the requirement to exchange collateral are applied consistently across the member states and harmonized operational procedures are introduced in order to provide clarity pertaining to the exemption process.

However, we consider it important that the contents of regulatory technical standards are delimited by the legislative act on which they are based. If the conditions set by RTS were such that, as a factual matter, exemptions could not be granted anymore, this would be contrary to the fundamental concept of Regulation (EU) No 648/2012 allowing the exemption of intra-group transactions from risk mitigation techniques that are otherwise applicable.

In addition to the response submitted by the German Insurance Association (*GDV*), we herewith provide you with our comments on issues we consider of particular importance.

Thus, in connection with the development of standards and requirements relating to the exemption of intragroup derivate transactions, the following should be taken into consideration:

## I. General remarks

### 1. The need for collateralization of intragroup derivative transactions

For a centrally managed group like Allianz, collateralization of intragroup derivative transactions is economically inefficient. The holding company is essentially the only point of access to capital for a subsidiary. Capital within the group is managed in a way to allocate to each subsidiary the capital it needs for its operating business. If the holding posted collateral with a subsidiary it would mean, in a

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first step, to allocate excess capital to that subsidiary. In a second step, the excess capital would be withdrawn by capital management measures thereby neutralizing the collateralization. Similarly, if the subsidiary posted collateral with the holding it would mean that the subsidiary's capital position is weakened causing the need for additional capitalization from the holding thereby, again, neutralizing the collateralization effect.

From an external perspective, intragroup derivative transactions only affect the internal parties involved without any impact on the market i.e. they do not change the risk profile of the group. This central management approach and the external market perspective are reflected in the consolidated accounts established in accordance with IFRS where, according to the "fiction of unity" intra-group transactions are neutralized because they do not influence the position of the group. Where intra-group derivative transactions are ultimately externalized through transactions with counterparties which do not belong to the group, such transactions must comply with all EMIR requirements. Accordingly, we see no risk that problems arising at the level of intra-group transactions may negatively affect transactions concluded with third parties.

## 2. Intra-group derivatives as recognized risk management tool

While we acknowledge the regulator's desire to avoid inflationary exemptions from the duty to post collateral, we view the draft RTS as too restrictive to comply with the general principle of proportionality in the proposed form as it would not only capture intragroup derivatives entered into for speculative or regulatory arbitrage purposes (see Preamble para. 17 draft RTS) but also those entered into as part of a consolidated risk management strategy pertaining to e.g. i) group-wide incentive plans or ii) foreign currencies ("**FX**").

a. In line with its centralized management approach, Allianz manages the risks set out above at the holding level as it avoids uncoordinated hedging activity from the subsidiaries, thereby increasing hedging efficiency and reducing external hedging requirements. For instance, equal but opposite FX exposure from various subsidiaries can be netted down such that only the residual FX exposure needs to be hedged externally, reducing the system-wide derivative notional. The external hedge will comply with applicable collateral requirements.

b. Furthermore, for many subsidiaries, in particular, mid- and small sized entities, it is not economically feasible to set-up the collateral management function that would monitor the exchange of collateral on a daily basis, which may lead them to prefer to take unhedged exposure rather than suffer the cost of implementing a fully functional and operative collateral management function. If intra-group transactions require collateralization, this will likely increase the tendency to take more unhedged exposure at the subsidiary level. With other words, a too conservative approach under the RTS may lead to a decrease of one systemic risk factor (counterparty risk) by increasing another systemic risk factor (unhedged exposure). In our view it seems questionable whether such shift in risk factors is an improvement with respect to the ultimate goal of the legislator when it enacted EMIR.

c. Finally, there are areas of intragroup derivative transactions which should be excluded from the scope of mandatory collateralization because they are too limited in size to pose a real systemic risk or threat. In addition, intra-group derivatives may be used for the purpose of hedging risks resulting from incentive plans for employees which transactions form part of remuneration schemes and which are not comparable to traditional financial instruments.

## 3. Collateralization requirements should be proportionate

Collateralization of effectively all intragroup derivative transactions would have far reaching negative effects on the efficiency of the group-wide risk management. Quasi-mandatory collateralization would, in essence, lead to a fragmented and rather complex risk mitigation structure, thereby introducing additional layers of operational and credit risks. In addition, the requirement to collateralize intragroup transactions would further increase complexity and constraints pertaining to the liquidity management, which itself will already be significantly affected by (i) the collateralization needs in respect of all OTC transactions that are centrally cleared and (ii) the increased liquidity demands resulting from other regulatory requirements like Solvency II or Basel III.

## II. How to define practical and legal impediments? (#112 Consultation Paper)

The RTS discusses two ways to tackle the question. The first alternative is to define specific cases in which practical and legal impediments are deemed to exist. As a second alternative, practical/legal impediments could be defined in a generic and broad manner without reference to specific cases.

### 1. Current proposal

The ESAs have opted for the first alternative on the grounds that a definition of specific cases might notably lead to a reduction of legal uncertainty and the provision of guidance to the relevant authorities on the criteria to grant the exemption.

### 2. Potential impact and downside of current proposal

a. However, in our view, it seems questionable whether additional clarity and guidance to local authorities can be provided merely by reference to specific cases pursuant to which legal/practical impediments are deemed to exist. Such cases and criteria are – based on the current draft proposal - either not clearly defined like the term "*regulatory restrictions*" or will need to be interpreted differently due to differences in local law like e.g. the reference to the concept of insolvency.

   In fact, we believe, that in particular an unlimited inclusion of restrictions stemming from insolvency or similar regimes as a criterion for a legal/practical impediment would de-facto eliminate the possibility to grant intra-group exemptions, given that the concept of insolvency law limiting the right to dispose of an asset is commonly accepted. Although it may have been the legislator's intention to adopt a conservative approach for the handling of exemptions (see #114 of the Consultation Paper), the de-facto elimination of intra-group exemptions would be contradictory to the declared goal of EMIR and the RTS to provide for the possibility of exempting intra-group transactions.

b. Furthermore, we consider the suggested approach structurally as too specific. Thus, limiting significantly the cases in which exemptions can be granted.

   Therefore, we believe it more constructive to adjust the criteria for intragroup exemptions to the overarching goal of the legislator to mitigate intragroup counterparty risk. At the same time, this would avoid the risk that RTS imply policy choices or policy decisions which might be in conflict with Art. 10 para.1 sub-para.2 Regulation (EU) No 1095/2010 (ESMA-Regulation). Otherwise the option within EMIR to apply for an exemption regarding intragroup transactions would become rather dispensable which clearly has not been the intention of the legislator when adopting EMIR.

### 3. Recommendation

We are of the opinion that a broader definition of what practical/legal impediments might be, would lead to a more balanced approach between the needs of appropriate intragroup counterparty risk mitigation on the one side and a realizable and workable solution for the groups concerned on the other side; therefore, we support Option 2 (as described in #115 Consultation Paper). The absence of material practical or legal impediments to the transfer of funds is a concept also used in specific areas of banking regulation ( cf. e.g. Art. 7 para 1a, para 3a EU-Regulation 575/2013 – CRR – with respect to derogations to the application of prudential supervisory requirements) without comparable specifications as those proposed in Art. 3 IGT. It appears that these specifications should be interpreted in a manner consistent with the corresponding banking regulation.

## III. Should restrictions stemming from insolvency, resolution or similar regimes be included in the legal impediments? (#117 Consultation Paper)

### 1. Current proposal

The current Consultation Paper includes as a criterion for a legal impediment to the transfer of own funds or the repayment of liabilities, any restrictions stemming from insolvency, resolution or similar regimes.

### 2. Potential impact and downside of current proposal

As rather different insolvency rules are (potentially) affecting intragroup derivative transactions and the vast majority of those rules limit the prompt transfer of funds from a legal or practical perspective, this approach would lead to the consequence that only very few transactions will benefit from the exemptions.

The draft impact assessment (#118 Consultation Paper) that is attached to the Consultation Paper speaks about uncollateralized exposure and the potential risks intragroup counterparties are facing stemming from the default of one of those intragroup counterparties, which (allegedly) should be the opposite of the purpose of bilateral margin requirements, if restrictions stemming from insolvency are not included as criteria for the exemptions.

However, we believe there should be a clear differentiation between uncollateralized intragroup transactions and uncollateralized external transactions which need to be reflected in the RTS. The legislator to EMIR explicitly recognized in the preamble (para. 39) that criteria for the exemption "*should take into account the prevailing specificities of those transactions [...] as well as their purpose and methods of using derivatives*"1. As outlined above, we see no risk that intra-group transactions may ultimately impact the financial system's stability through external derivative transactions, given that the latter must always comply with EMIR-requirements for central clearing or collateralization.

### 3. Recommendation

Restrictions stemming from insolvency, resolution or similar regimes in general should not be included as a criterion for legal/practical impediments to transfer own funds or to repay liabilities (Option 2, #120 Consultation Paper).

## IV. Should a restriction be deemed to exist due to "current or potential limitation on the ability of a counterparty to promptly transfer own funds or repay liabilities when due between counterparties"?

### 1. Current proposal

Pursuant to the current Consultation Paper a restriction is deemed to exist if there is a current or potential limitation on the ability of a counterparty to promptly transfer own funds or repay liabilities when due between counterparties

### 2. Potential impact and downside of current proposal

We acknowledge the ESA's aim to introduce a definition of legal impediments that is broad enough to capture all potential restrictions regarding the ability to transfer funds. However, we would like to highlight that after the introduction of such a "catch all approach" we see a risk that essentially no emptions for intra-group transactions could be granted. The reason for that is – similar to the considerations made under III. above – the rampant and unjustified wide scope of the definition by referring to a concept of company law that is generally applicable. Thus, when interpreted in a strict manner, the restriction due to "current or potential limitation on the ability of a counterparty to promptly transfer own

[1] No 39 of Regulation (EU) 648/2012 of the European Parliament and the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR)

funds or repay liabilities when due" will be applicable in nearly every circumstance an intragroup transaction takes place leaving only a very limited number of transactions benefitting from the exemption.

### 3. Recommendation

The additional condition "*no current or potential limitation on the ability of a counterparty to promptly transfer own funds or repay liabilities when due between counterparties*" that has been proposed within the Consultation Paper requires a restrictive interpretation.

## V. Comparable requirements pursuant to current supervisory law in the banking sector

It appears that the criterion "absence of impediments to the transfer of own funds or repayment of liabilities" has been modelled on a precedent from the banking sector (cf. Art. 67 Directive 2006/48/EC and Art. 7, 113 EU Regulation 575/2013, CRR).

Pursuant to this legislation, the absence of material impediments to the transfer of own funds or repayment of liabilities is a prerequisite to allow for certain exemptions in the field of banking supervision, e.g. supervision of certain banking entities on a group-basis only. This approach recognizes the going-concern perspective for supervisory purposes. Against this background, the mandate given in Art. 11(15)(d) EMIR to define "practical and legal impediments to the transfer of own funds and the repayment of liabilities" should be used to achieve a comparable concept.

## VI. Proposal for implementation of Intra-group exemptions

In consideration of the recommendations made above we would propose to supplement Art. 3 para. 1 IGT as follows:

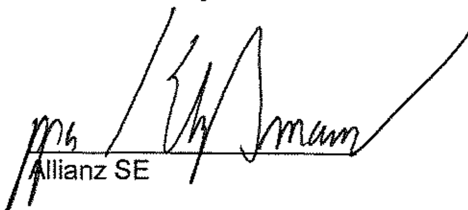
Art. 3 IGT – Practical or legal impediment

1. A legal impediment to the prompt transfer of own funds or repayment of liabilities between the counterparties as referred to in paragraphs 5 to 10 of Article 11 of Regulation (EU) No. 648/2012 shall be deemed to exist where under the laws applicable to counterparties, or under the contractual relationship between the counterparties, or between a counterparty and a third party, there are any current or anticipated restrictions including
   - **a.** currency and exchange controls,
   - **b.** regulatory restrictions
   - **c.** restrictions stemming from insolvency, resolution or similar regimes
   - **d.** current or potential limitation on the ability of a counterparty to promptly transfer own funds or repay liabilities when due between the counterparties.

   ***For this purpose, restrictions shall be deemed current or anticipated, if concrete restrictive actions or effects materialize or are imminent to materialize.***

We appreciate the opportunity to submit our views on the Consultation Paper. Please do not hesitate to contact us should you have questions or if we can provide any more detail.

Yours sincerely,



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