Institutional protection systems: are they banking groups?

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In the eurozone, a large proportion of savings banks and co-operative banks belong to institutional protection systems, within which they undertake to support each other mutually. From a strictly accounting point of view, these networks do not constitute banking groups. However, regulators recognise that they are highly integrated and allow their members to apply a prudential treatment similar to that used by companies belonging to consolidated groups. These mutual support arrangements are to some extent part of the trend towards consolidation in the banking industry.

European networks of savings banks and co-operative banks are currently reorganising. For some, the aim is to simplify their ownership structure and increase their solvency, for example networks of agricultural credit cooperatives in France and of mutual banks in Austria and the Netherlands. For others, the aim is to clarify their mode of governance and their internal mutual support mechanism, as is the case with networks of credit unions in France and of savings banks and co-operative banks in Germany. Finally, some networks want to strengthen their ties, for example networks of savings banks in Austria and of credit co-operatives in Spain and Italy. As a result, certain banking networks have, in the last few years or months, become more integrated in one way or another.

The economic context, along with increasing competition, new European regulations and the single supervision framework, are all challenges for local savings and co-operative banks, which are relatively small, lack diversification, are heavily dependent on interest income, and carry out large-scale maturity transformation via their balance sheets. That is especially true when their ownership structure prevents them from strengthening their equity by raising funds in the market.

In the eurozone, the vast majority of local savings banks and credit co-operatives are not isolated, but belong to co-operation and mutual support networks. European legislation recognises some of these networks as institutional protection schemes or IPSs. To achieve that status and benefit from the related regulatory framework, banks must meet a set of conditions and criteria defined by the European regulator and supervisor.

Although they are not widely known, the relevance of IPSs is significant. According to the ECB, in the eurozone, around 50% of credit institutions are members of an IPS, representing almost 10% of total bank assets. However, that average masks wide variations because IPSs are only recognised in three countries at the moment. Germany and Austria have the main ones, and Spain has two smaller ones. Three out of four institutions belong to an IPS in Germany and four out of five in Austria. In terms of total assets, they account for 40% of the banking sector in Germany and 50% in Austria. These institutions play a major role in financing the economy but also in ensuring financial stability, not individually but collectively.

We will first set out the economic rationale for forming networks, and the two organisational forms that they generally use. We will then look at the criteria for identifying institutional protection schemes and their modes of governance. IPSs are not banking groups from an accounting point of view. Although, like mutual groups, they use one or more central institutions within the network to carry out centralised management of liquidity and ensure their members' solvency and liquidity, each member of an IPS is independent. However, regulators recognise that they are highly integrated and allow institutions that are members of the same IPS to apply a prudential treatment similar to that used by companies belonging to a mutual group. Although certain IPSs have been or could be the precursors to genuine banking groups – in Austria, Spain and Italy for example – other IPSs have remained highly decentralised. This is particularly the case with German IPSs, for which we have devised a "consolidated" view to assess their financial characteristics and their contribution to financing the German economy.

Autonomous institutions united through a network

Historically, savings banks and co-operative banks have played a central role in most European financial systems (see Bülbül, Schmidt and Schüwer [2013][1] for a study of the history of these two groups of financial institutions in Europe). They appeared in the 19th century as a result of local initiatives, driven in most cases by groups of citizens or the public authorities. For a long time they were relatively similar, but the wave of deregulation and privatisation in the 1980s and 1990s caused major changes to their roles, institutional structures and business models. In some countries, savings banks and mutual banks have totally disappeared as specific groups of financial institutions. In others, they have taken on characteristics similar or identical to those of traditional commercial banks. National legislation has played a crucial role in this growing differentiation. Legislation in some countries allows banks to offer a wide range of financial services to their customers; in others, it has converted them into joint-stock companies and allowed private investors to buy stakes in them; and in others still, it has abolished the principles of regional demarcation and non-competition between banks. In particular, legislation has caused major changes to the savings bank sector in Spain. Germany is an exception, since its savings banks and co-operative banks have retained most of their original features. We will see below that those features depend to a very large extent on the institutional structure of the networks to which they belong.

The economic rationale for networks

Institutions focused on collecting savings locally

The business models of European local savings and co-operative banks do not differ radically. They have mainly remained consistent with one of their original features, i.e. their focus on collecting savings from and lending to retail customers (individuals, associations and small and medium-sized companies). Although not a legal requirement in most countries (except Germany), they generally comply with a "regional principle", that restricts their activities to a specific local or regional area. Their local focus gives them a relatively large deposit base, while their close ties with customers mean that they have good knowledge of local risks. Whereas mutual banks are organised according to the club model (their capital is owned by members that are also customers of the co-operative), savings banks are more varied in terms of their shareholder structures. Most of them are no longer public-sector institutions. However, some continue to operate under a public law regime and have public interest missions, and so cannot fall under the control of private-sector interests.

Distribution of roles within the network

Something else that most savings banks and mutual banks have in common is that they belong to very dense networks comprising legally autonomous institutions with distinct business models. Those networks generally have a three-tier architecture (local, regional and national) that works according to the principle of subsidiarity: the local bank carries out the main functions of a bank branch, and the other tiers do the things that the local bank cannot do itself, such as securities trading, financing of exporter customers and support for their foreign operations, access to hedging products, cash management and payment methods. This network organisation allows banks to operate under a common brand name, achieve economies of scale (by pooling certain functions, particularly back office functions) and offer customers a wide range of products and services (by outsourcing certain businesses and/or functions to other institutions specialising in areas such as asset management and investment banking). Networks also have centralised liquidity management. Local banks place their surplus funds with central institutions, which act as central banks and clearing houses for all members of the network. Local banks are traditionally shareholders in and net creditors of these institutions. The flow of liquidity within the network makes the central institutions, which generally lack a stable deposit base, less dependent on market financing and allows local banks to pass on part of their maturity transformation risk. Finally, one specific feature of savings-bank and mutual-bank networks, which is less well known but which we will analyse in this article, relates to the mutual support commitments, contractual or statutory, that bind their members.

Two network organisational structures

A network of co-operative or savings banks can show a varying level of integration depending on whether its members choose to apply this mutual support within a banking group with a central body (of the type mentioned by article 10 of European regulation 575/2013 of June 2013, also known as the Capital Requirements Regulation or CRR) or within an institutional protection scheme (of the type mentioned in article 113(7) CRR). We will set out below what differentiates between the two types of organisation and also what they have in common. The compliance of networks and their members with the CRR's requirements is crucial, because it entitles them to certain prudential exemptions and/or derogations[2]. These are partly inspired by the framework reserved for entities in a consolidated banking group: members of a network do not need to hold capital to cover risks arising from their exposure to other members of the same network and those exposures are not subject to the limits of the regime applicable to major risks[3]. Moreover, the application of article 113(7) is a prior condition for the granting of additional derogations (see below). The rationale for forming the network must justify the derogations, as the sharing of tasks within the network needs to be accompanied by substantial reciprocal commitments.

Since the introduction of the single supervision mechanism (SSM), the final decision to grant IPS status to a group of institutions for prudential purposes, or the status of member of an existing IPS to an institution, lies with the ECB. The relatively vague nature of the conditions set out in the CRR (see below) gives the single supervisor a margin of appreciation, and it states that it takes decisions on a case-by-case basis. Where an IPS includes institutions deemed "significant"[4] that are under the direct supervision of the ECB, as well as others deemed "less significant", the ECB and the competent national authorities work together to define the relevant regulatory framework and monitor the IPS concerned[5].

As we mentioned above, IPSs have considerable importance in the eurozone. Currently, IPSs are recognised for the purposes of the CRR in three countries taking part in the SSM: two in Germany, eight[6] in Austria and two in Spain within the mutual and/or savings bank sectors[7]. Italy's co-operative credit banks (CCBs) are currently undergoing organisational reform, combining them into a single structure with a head holding company, controlled by the CCBs and tasked with intervening in the event that a governance failure takes place or a CCB experiences difficulties. This could allow the new group to attain IPS status. At the moment, none of France's mutual bank networks have IPS status. The French Monetary and Financial Code identifies them as institutions permanently affiliated to a central body within the meaning of article 10 CRR. This type of network exists in at least six member-states[8]. Table 1 (page 6) below includes some examples of IPSs and groups with central bodies, although it is not exhaustive.

Criteria for identifying an institutional protection scheme

While certain networks set up mutual support systems as early as the 1970s, to our knowledge, it was directive 2006/48 of the European Parliament and of the Council (June 2006), relating to the taking up and pursuit of the business of credit institutions, that introduced the term "institutional protection scheme". The European regulation defines an IPS as a "contractual or statutory liability arrangement which protects those institutions and in particular ensures their liquidity and solvency to avoid bankruptcy where necessary" (article 113(7) CRR). In some respects, this mutual support mechanism is similar to that which exists in a group with a central body. A central body must take all necessary measures to ensure the liquidity and solvency of all affiliated institutions and of the network as a whole (article 10 CRR). In our view, the main difference between the two types of organisation lies in the degree of independence granted to local banks (see table 2, pages 10 and 11).

We will first discuss the terms under which a mutual support system can qualify as an IPS for prudential purposes. We will base our analysis mainly on three types of documents: 1) the EC regulation concerning prudential requirements (CRR) of June 2013[9] (and the delegated regulation that goes alongside it[10]), 2) two

Examples of IPSs and groups with central bodies
Summarized organisational form; data at end 2015

	Institutional protection schemes		Banking groups with central bodies
Germany	Network of savings banks : Sparkassen-Finanzgruppe, or S-Group, steered by the DSGV : 413 local savings banks, 7 central institutions (Landesbanken), various banks with special functions ; EUR 2 800 bn of total assets, fund assets and aggregate holdings ("consolidated" total assets of EUR 1 925 bn at end 2015, see box) Network of credit cooperatives : Genossenschaftliche FinanzGruppe Volksbanken Raiffeisenbanken, steered by the BVR : 1 021 local Volksbanken and Raiffeisen banks, 2 central institutions* (DZ Bank and WGZ Bank), various banks with special functions ; consolidated total assets of EUR 1 163 bn	**France**	Networks of mutual banks : Groupe Crédit Agricole : 2 476 local banks, 39 regional banks, 1 central body (Crédit Agricole S.A.), various specialised subsidiaries ; consolidated total assets of EUR 1 698.8 bn Groupe BPCE : 18 Banque Populaire banks and 17 Caisses d'Epargne, 1 central body (BPCE S.A.), various specialised subsidiaries ; consolidated total assets of EUR 1 166.5 bn Groupe Crédit Mutuel : 2 124 local mutual banks, 18 regional groups, 1 central body (CNCM), various specialised subsidiaries ; consolidated total assets of EUR 739.8 bn
Austria	Network of savings banks : Erste Group : 47 local savings banks, 1 parent company (Erste Bank), various banks with special functions ; consolidated total assets of EUR 199.7 bn Network of Raiffeisen banks : RZB Group : 474 local Raiffeisen banks, 8 regional Raiffeisen banks, 1 parent company (RZB AG), various banks with special functions ; consolidated total assets of EUR 138.4 bn Network of Volksbanken : Osterreichische Volksbanken-Aktiengesellschaft (VBAG), steered by the OGV : 26 regional Volksbanken, 1 parent company (VBW), various banks with special functions ; consolidated total assets of EUR 27.8 bn	**Netherlands**	Network of cooperative banks : Rabobank Group** : 106 local Rabobanks, 1 central body (Rabobank Nederland), various specialised subsidiaries ; consolidated total assets of EUR 670.4 bn
Spain	Networks of savings banks and credit cooperatives : Grupo Cooperativo Cajamar : 19 *Cajas*, 1 parent company (Banco de Crédito Social Cooperativo S.A.); consolidated total assets of EUR 40.5 bn Grupo Cooperativo Solventia : 6 *Cajas*, 1 parent company (Caja Rural de Almendralejo, SCC) ; consolidated total assets of EUR 1.6 bn	**Finland**	Network of cooperative banks : OP Financial Group : 180 member cooperative banks, 1 central body (OP Cooperative), various specialised subsidiaries ; consolidated total assets of EUR 125.1 bn

* The two central institutions merged on August 1st, 2016.
** Rabobank Group changed its governance structure on January 1st, 2016 : the local Rabobanks and the central body merged into a single legal entity. The local Rabobanks became branch-like entities of the new Rabobank Group; Rabobank Nederland became the parent company.

Table 1 Sources : Banks' financial reports, BNP Paribas

ECB guides (the March 2016 guide on options and discretions[11], and July 2016 guide on the approach for the recognition of institutional protection schemes for prudential purposes[12]) and 3) financial reports published by certain IPSs.

Mutual commitments and obligations

IPS members

The mutual support system "shall be based on a broad membership of credit institutions [established in the same member-state] of a predominantly homogeneous business profile" (article 113(7)(h) CRR). The wording is fairly vague: the terms "broad membership" and "predominantly homogeneous" have no legal definitions.

"Broad membership" must allow the diversification of risk, at least geographically (the members of the first tier of a network generally address a local market), along with the pooling of contributions from a large number of institutions. The scale of the risks to be covered also increases as the number of participants rises. However, pooling is especially justified given that the shareholder structure of IPS members generally makes it harder for them to recapitalise in a crisis. Local savings and co-operative banks, which form the basis of IPSs, are usually owned by their member-customers or have public body status, so that they can only strengthen their capital by setting aside profits as reserves. This is the case with German savings banks, which moved away from municipal ownership in the 1930s. Their status as public bodies means that neither the government, a municipality or district, nor private investors, can own their capital. In a sense, German Sparkassen "belong" to the community. Or, as their federation terms it, to "citizens"[13].

A "predominantly homogeneous business profile" means that it should be easier to monitor risks at the network level using uniform systems for measuring and analysing risks (article 113(7)(c) CRR). However, the economic rationale for forming a network (economies of scale and scope, liquidity flows and centralised liquidity management) provides a justification for business profiles not to be entirely homogeneous. An IPS can therefore bring together some fairly different institutions (a network of local retail banks and one or more banks with international investment banking activities, for example), provided that the sample is large enough, especially since this allows a degree of risk diversification. Finally, this criterion must be assessed on the basis of each member's contribution to the way the network functions. In particular, the ECB assesses the extent to which "the business activities of the IPS members are related to the IPS network (products and services provided to local banks, services to shared customers, capital market activities etc.)".

The mutual support system

The mutual support system is to some extent similar to a private bail-out (undertaken by the creditors or external shareholders of the group in difficulty, not included in the group but members of the same IPS), providing protection for the network's external creditors. The regulation does not define the exact point from which support must be provided, or the rules for triggering the mechanism. The IPS must be capable of taking preventive action to help its members recover (by definition, before any resolution measure). In that respect, the IPS may comply with the specific regime established by the European directive on recovery plans (Bank Recovery and Resolution Directive or BRRD), and its members may be exempted from it. For that to happen, the IPS must ensure that its members meet regulatory capital and liquidity requirements on an individual basis. It must also conduct "its own risk review which is communicated to the individual members" (article 113(7)(d) CRR). Where there is a risk of insolvency and preventive measures are insufficient, "the IPS needs to decide on material or financial support". It must have a "suite of available actions ranging from less intrusive measures, such as closer monitoring of the member institutions on the basis of relevant indicators and additional reporting requirements, to more substantial measures that are proportionate to the riskiness of the beneficiary IPS member institution and the severity of its financial constraints, including direct capital and liquidity support". Support provided to one member of the network may take the form of loans or advances, capital or guarantees. Measures to bolster the balance sheet, to restructure the business or to revise the business model may be imposed on the

institution in difficulty. There must be "no current or foreseen material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities from the counterparty to the institution" (article 113(7)(a) CRR). No third party, defined as "any party that is not the parent, a subsidiary, a member of the decision-making bodies or a shareholder of an IPS member institution" must be able to exert control or prevent these transfers. The IPS must also be "able to grant support necessary under its commitment from funds readily available to it" (article 113(7)(b) CRR). To quantify the need for additional funds, the IPS must carry out stress tests at regular intervals.

To minimise *ex-ante* moral hazard risks and *ex-post* contagion risks, IPSs must establish the contributions of their members depending on their risk profiles, and do not generally promise unconditional and unlimited support for their members. As a result, although there must be "a clear commitment [...] on the part of the IPS to provide support when – despite previous monitoring of risks and early intervention measures – an IPS member is or is likely to become insolvent or illiquid", that commitment remains conditional: an IPS is a system of mutual commitments and obligations. The appropriateness of providing financial support to an IPS member must be assessed in view of its financial position and its past risk-taking, available funds and the ability of other members to replenish funds afterwards. Infringing the terms of the arrangement, for example the network's risk policy, could be a reason for refusing a request for support, or even for excluding an institution from the IPS. The conditions for using the funds are even stricter where the IPS has the dual function of a mutual protection system and a deposit guarantee system[14] (which is the case for the two German IPSs).

This conditionality is shown by the fact that prior approval is needed from members of the German savings bank association's decision-making committee (qualified majority of 75%) before the mutual support system is triggered. This way of taking decisions is similar to that of a banking group. Although, a parent company is not generally obliged to protect its subsidiaries (unless it explicitly takes responsibility for doing so with respect to the regulatory authorities[15]), it can in principle take part in recapitalising its subsidiaries but only following agreement by the board of directors. Similarly, as mentioned in the European regulations, "it may not be assumed that credit institutions will always receive liquidity support from other undertakings belonging to the same group or to the same institutional protection scheme when they experience difficulties in meeting their payment obligations".

A single representative, but highly independent members

The steering entity of an IPS

To facilitate communication with the supervisory authorities, and similar to institutions permanently affiliated to a central body, members of an IPS must appoint a single point of contact tasked with ensuring compliance with the arrangement's provisions. Within groups with a central body, this point of contact handles network's central bank functions (centralised liquidity management) and guarantees mutual financial support[16]. Within IPSs, however, those two remits are separated: one or more institutions, in which the banks are shareholders (but not necessarily majority shareholders), assume the role of central bank, while another institution organises mutual support within the network. It represents the network with respect to the public authorities and regulatory and supervisory authorities, handles reporting obligations (see below), ensures the cohesion of members and manages the mutual support mechanism. Although an association traditionally takes that role within an IPS (for example, the association of German savings banks, DSGV, or the association of German mutual banks, BVR), the mutual support system may also be handled by a company set up from scratch and entirely owned by network members (for example Haftungsverbund GmbH within the network of Austrian savings banks).

Autonomous and independent members within IPSs

The desire to remain independent while benefiting from the advantages of a network is probably one of the main reasons for choosing to take part in an institutional protection scheme. By comparison, institutions affiliated to a central body are autonomous in legal terms but under the control of the central body. According to the CRR, an

IPS must be able to "take influence" over its members (article 113(7)(c) CRR). This may be done through recommendations, penalties or even the exclusion of members that do not comply with the terms of the liability arrangement. By contrast, the IPS does not seem able to take any overly intrusive or coercive measures, or to get involved in the management of the institutions[17]. In their original form (see below), IPSs are not hierarchical systems dominated by a central power in either law or practice. These networks are not vertically integrated[18]. However, where the steering entity's prerogatives go so far as to allow it to exert control over the local or regional banks, justifying consolidation of the financial statements, the network takes a much more integrated and vertical form, i.e. that of a banking group (such as the Austrian savings banks included as subsidiaries in Erste Group's scope of consolidation for example, see below).

Less independence within groups with a central body

A central body is authorised to "issue instructions" to institutions affiliated to it (article 10(1)(c) CRR). The local and regional banks of a group with a central body have a large amount of autonomy in their lending decisions, for example, but the group's policy and strategy are set centrally. The central body ensures that the regional banks comply with internal control and risk management procedures, defined according to the guidelines set by the group's executive management. In France, the Monetary and Financial Code also specifies that central banks can forbid or limit the distribution of dividends to shareholders or the remuneration of member shares paid to members of their affiliated institutions. Where justified by the financial position of the institutions concerned, and after informing their regulator, central bodies can decide to merge two or more institutions affiliated to them, to sell some or all of their business, and to dissolve them.

In France, the current dispute between the inter-federal bank Crédit Mutuel Arkéa and the central body of the Crédit Mutuel group (Confédération Nationale du Crédit Mutuel or CNCM), is a reminder that members of these organisations need to adhere to common values and interests. Crédit Mutuel Arkéa wants to maintain its independence while continuing to use the Crédit Mutuel brand, while CNCM wants to maintain the unity of the network, the group's status and the application of the related regulatory framework[19]. CNCM is opposing Crédit Mutuel Arkéa's proposal to create several central bodies within the group (contrary to the group's co-operative model, banking law and the position of the supervisory authorities), and in October commenced a sanction procedure that could eventually result in Crédit Mutuel Arkéa being excluded.

Hybrid regulatory treatment

In its original form, an IPS is not a banking group from the accounting point of view. Each member prepares its own consolidated financial statements according to accounting standards in force. Unlike institutions of a consolidated banking group, the members of an IPS are not under the control of a single legal entity. There is also no rule that governs their ownership links. For the purposes of prudential supervision, however, every IPS is required to publish financial reports that give the widest possible view of the network. These publications are a prerequisite for IPS members to obtain derogations. The more integrated the network, the more extensive the derogations. Table 2 (pages 10 and 11) summarises the aforementioned accounting and prudential aspects.

Consolidation rules within banking groups

Rules closely related to the notion of control within consolidated groups

In accordance with accounting standards in force in Europe, the scopes of consolidation and the consolidation methods of banking groups are closely related to the notion of control. In legal terms, a parent company controls a subsidiary when its relations with the subsidiary expose it or entitle it to variable returns and when it has the ability to influence those returns because of the power it exerts on the subsidiary. In the case of entities governed by voting rights, the general view is that a group controls another entity if it holds, directly or indirectly, a majority of its voting rights and if there are no other agreements that impair the power of those voting rights. In the case of a conventional group, the consolidated financial statements and consolidated management report prepared by the parent company include the financial statements of controlled companies, jointly controlled companies and

Main characteristics of and prudential derogations associated with IPS status

	Conventional banking group	Banking group with a central body	Institutional protection scheme		
		Co-operative network within the meaning of article 10 CRR	Type-1 IPS (art. 113 para. 7)	Type-1b IPS (art. 49 para. 3)	Type-2 IPS (art. 84 para. 6)
Group status from the strictly accounting point of view	Yes	Yes	No	No	Yes
Group/network with legal personality	No	No	No	No	No
Group/network organisation	Vertical	"Non-centralised"	Horizontal	Horizontal	Vertical
Member companies legally autonomous	Yes	Yes	Yes	Yes	Yes
Members are highly independent with respect to the parent company / central body / steering entity	No	No (affiliated institutions are relatively independent)	Yes	Yes	No
Branches/banks have local or regional focus	Yes	Yes	Yes	Yes	Yes
Branches/banks share a common brand	Yes	Yes	Yes	Yes	Yes
Number of branches/banks	Unlimited	Unlimited	Large	Large	Large
Business profile within the group/network	Unlimited	Unlimited	"Predominantly homogeneous"	"Predominantly homogeneous"	"Predominantly homogeneous"
Group subsidiaries / network members are protected against illiquidity and insolvency	No (except under art. 7(1)(b)	Yes	Yes	Yes	Yes
Liquidity is managed centrally at the level of the parent company / of the central body / of one or more central institutions	Yes	Yes	Yes	Yes	Yes
Accounting consolidation of group / network members	Yes	Yes	For supervisory purposes: consolidation or aggregation of financial statements	For supervisory purposes: consolidation or extended aggregated calculation	Yes
Consolidating entity at the group/network level	Parent company	Central body and affiliated institutions	No	No	Parent company
Accounting scope of consolidation	Companies under the control of the consolidating entity	Companies under the control of the consolidating entity	All members of the IPS	All members of the IPS	Companies under the control of the consolidating entity
Point of contact with the supervisory authorities	Parent company	Central body	IPS steering entity	IPS steering entity	Parent company
Group/network under the ECB's direct supervision	Yes where its size is deemed "significant"	Yes where its size is deemed "significant"	No (only network members can be identified as "significant")	No (only network members can be identified as "significant")	Yes where its size is deemed "significant"
Group/network may be subject to increased capital requirements because of its systemically important status (domestic or global)	Yes	Yes	No (only network members can be identified as systemically important)	No (only network members can be identified as systemically important)	Yes
Compliance with minimum weighted capital requirements:					
a. on a consolidated basis	a. Yes	a. Yes	a. No	a. Yes	a. Yes
b. on an individual basis	b. Yes (possible derogation, art. 7)	b. Yes (possible derogation, art. 10)	b. Yes	b. Yes	b. Yes (possible derogation, art. 7)

Possible derogations on an individual basis (CRR 575/2013):					
a. Exposures (excluding own funds items) to another member of the group/network have a risk weight of 0%	a. Yes (art. 113 para. 6)	a. Yes (art. 113 para. 6)	a. Yes (art. 113 para. 7)	a. Yes (art. 113 para. 7)	a. Yes (art. 113 para. 7)
b. Limits to large exposures are not applied to intra-group/intra-network exposures	b. Yes (art. 400)	b. Yes (art. 400)	b. Yes (art. 400)	b. Yes (art. 400)	b. Yes (art. 400)
c. Holdings of own funds instruments issued by institutions included in the scope of consolidated supervision not deducted	c. No (chap. 2(5) ECB)	c. Yes (art. 49 para. 3, b)	c. No	c. Yes (art. 49 para. 3, a)	c. Yes (art. 49 para. 3, a)
d. Minority interests included in the group/network's consolidated common equity Tier 1 capital	d. Zero or partial (art. 84 para. 1)	d. Zero or partial (art. 84 para. 1) (full in the case of art. 84 para. 6)	d. No	d. Zero or partial (art. 84 para. 1)	d. Full (art. 84 para. 6)
Compliance with liquidity coverage requirements (LCR):					
a. on a consolidated basis	a. Yes	a. Yes	a. No	a. No	a. Yes
b. on an individual basis	b. Yes (possible derogation, art. 8)	b. Yes (possible derogation, art. 10)	b. Yes	b. Yes	b. Yes (possible derogation, art. 8 para. 4)
Possible derogations on an individual basis (delegated regulation 2015/61)					
a. Intra-group or intra-network deposits are exempted from the rule limiting liquidity inflows to 75% of liquidity outflows	a. Yes (art. 33)	a. Yes (art. 33)	a. Yes (art. 33)	a. Yes (art. 33)	a. Yes (art. 33)
b. Symmetrical inflow and outflow rates can be applied to liquidity flows between two institutions belonging to the same group/network	b. Yes	b. Yes	b. Yes	b. Yes	b. Yes
c. Sight deposits that a member maintains with the group/network's central body/institution and liquid funding from the central body/institution or another network member can be treated as liquid assets (provided that such funding is not secured by liquid assets)	c. No	c. Yes (art. 7 and 16)	c. Yes (art. 7 and 16)	c. Yes (art. 7 and 16)	c. Yes (art. 7 and 16)
d. Application of a lower outflow rate (25%) where the depositor is a member of the same group/network (provided that those deposits are not recognised as liquid assets)	d. No	d. Yes (art. 27)	d. Yes (art. 27)	d. Yes (art. 27)	d. Yes (art. 27)
e. Application of a lower outflow rate for undrawn credit or liquidity facilities where the counterparty is a member of the same group/network (symmetrical or more prudent liquidity inflow applied by the counterparty)	e. Yes (art. 29)	e. Yes (art. 29)	e. Yes (art. 29)	e. Yes (art. 29)	e. Yes (art. 29)
e. Application of a higher inflow rate for undrawn credit or liquidity facilities where the counterparty is a member of the same group/network (symmetrical or more prudent liquidity outflow applied by the counterparty)	e. Yes (art. 34)	e. Yes (art. 34)	e. Yes (art. 34)	e. Yes (art. 34)	e. Yes (art. 34)

Table 2 Source : BNP Paribas

companies over which it has significant influence[20]. No other company owns a majority stake in the parent company, either directly or indirectly. Capital and liquidity requirements apply on a consolidated basis and, barring a derogation, on an individual basis[21].

Groups with a central body: an inverted ownership structure

Within mutual networks that are organised as banking groups with central bodies, the notion of control is also crucial, but separate from ownership links. The scope of consolidation reflects the community of interests that exists, in legal, financial, economic and political terms, between the central body and the institutions affiliated to it (local and regional banks). The unique aspect of this type of organisation is that the ownership structure is inverted: the central body, which is in charge of the network's governance and to which the supervisor gives the power to control its affiliates, is owned, in part or in whole, by its affiliates. That control is exerted even where the central body owns no member shares in the banks. That is the case, for example, of the central bodies of French mutual groups Crédit Mutuel and BPCE, which are wholly owned by the institutions affiliated to them[22]. Until July 2016, the Crédit Agricole group's ownership structure was slightly more complex than that of its peers, involving cross-shareholdings in which the banks owned 56.7% of the central body's shares, and the central body owned around 25% of the shares in the banks. However, it met the definition of a group with a central body[23]. In these groups, the central body and its affiliates make up the "consolidating" entity. As a result, the consolidated financial statements of a group with a central body fully consolidate the financial statements of the central body and of its affiliates. They also include the financial statements of companies over which, under IFRSs, the consolidating entity has control, joint control or significant influence. Each member of the group that has parent-company status must also publish consolidated financial statements, including the central body. Capital and liquidity requirements apply on a consolidated basis and, barring a derogation (which is the biggest regulatory benefit for members of mutual groups compared with members of an IPS), on an individual basis[24].

Consolidation rules within IPSs

The scope of aggregation or consolidation

All IPSs must publish, at least once a year, a financial report "comprising the balance sheet, the profit-and-loss account, the situation report and the risk report, concerning the institutional protection scheme as a whole" (article 113(7)(e) CRR). To that end, it may adopt either a consolidated approach or an aggregate approach[25]. Consistent with the main derogation granted to members of an IPS (zero weighting for intra-network commitments when calculating risk-weighted assets), where the IPS prepares a report on an aggregate basis, the aggregation method may lead to the elimination of all intra-network exposures[26]. The ECB recommends that all members of the IPS, their subsidiaries and the special entity steering the IPS (if it is a legal entity) be included in the scope of consolidation or aggregation[27], independently of their ownership links.

A simple example is the IPS of the network of German co-operative banks within which local co-operative banks own 100% of the central institution (DZ Bank). Ownership links within the network of savings banks (S-Group) are more complex. Historically, the ownership of most central institutions, which are also the banks of Germany's Länder (Landesbanken), was split equally between the Länder and the savings banks (Sparkassen). However, the structure changed following the 2007/08 financial crisis, because the recapitalisation of regional banks was borne mostly by the Länder. The Sparkassen now own around 30% of the Landesbanken, but there are wide variations: they own 87.8% of Helaba but only 5.6% of HSH Nordbank for example. However, all Landesbanken remain consolidated in the S-Group.

Unequal recognition of the mutual support system

Where the IPS shows a relatively low level of integration, these reports are used for risk monitoring purposes. However, the network's solvency and liquidity are not monitored on the basis of these financial statements (type-1 IPS in table 2, pages 10 and 11) but only on an individual basis (without any further derogations than the zero weighting for intra-network commitments and the exemption to limits to large exposures). Where the IPS

prepares, on the contrary, a consolidated balance sheet or carries out an "extended aggregate calculation" (which the relevant authorities deem equivalent to the requirements of the European regulation regarding the consolidated financial statements of credit institutions)[28], and where members of the IPS meet together the weighted capital requirements, additional prudential derogations are provided for on an individual basis, in particular the permission not to deduct interests in equity instruments issued by another member of the IPS (article 49(3) CRR, see type-1b IPS in table 2). The IPS of the network of German co-operative banks, and probably also the IPS of the network of German savings banks (although the DSGV is less explicit on the matter) benefit from the derogation under article 49[29].

Although the prudential treatment of each member of an IPS shows some similarities with that of companies belonging to a consolidated banking group (see table 2, pages 10 and 11), certain rules do not apply to the IPS as a whole. No IPS is, as a whole, considered as part of the identification of "significant" institutions by the ECB, of global systemically important banks (G-SIB) by the Financial Stability Board (FSB) or even of domestic systemically important banks (D-SIB) by national supervisors. Each member of an IPS can be identified as a D-SIB or G-SIB but not the IPS as a whole. In other words, an IPS cannot be subject to increased prudential requirements.

Special case: IPSs integrated into consolidated groups

Where an IPS takes a more integrated form – that of a group – the capital calculation arrangements are more inclusive also. Institutions that are part of the same IPS (as with institutions permanently affiliated to a central body if their mutual support mechanism has IPS status) and that have set up a cross-guarantee scheme within the meaning of the CRR (article 4(127) CRR) may recognise any minority interest[30] arising in the cross-guarantee scheme[31] in full in own funds (article 84(6) CRR, see type-2 network in table 2). This requires in particular that the group prepare consolidated financial statements and that all members be included in the consolidated supervision of a parent company. A cross-guarantee scheme is a liquidity and solvency support contract between members of a banking group (the parent company and its subsidiaries). This is a long-term type of arrangement (the minimum notice period for voluntarily leaving such a scheme is 10 years), and so involves much more of a commitment than a simple IPS (notice period for ending the IPS is 24 months, see article 113(7)(f) CRR). It also establishes closer relations between the parent company and its subsidiaries than in a conventional banking group. As for groups with a central body, the scope of consolidation is based on joint and several commitments and the governance principles that bind the members of the cross-guarantee scheme. This type of arrangement exists in Austria and Spain, where certain savings banks and co-operative banks are organised as banking groups (Erste Group and RZB Group in Austria, Grupo Cooperativo Cajamar in Spain). Capital and liquidity requirements apply on a consolidated basis and, barring a derogation, on an individual basis. For example, members of the Grupo Cooperativo Cajamar IPS (except for the group parent) are not subject to prudential requirements on an individual basis.

The Austrian networks are a good illustration of the specific case of IPSs integrated within banking groups. Because of their cross-guarantee scheme (Haftungsverbund von Sparkassengruppe)[32], Austrian savings banks are included as subsidiaries in the accounting and prudential scope of consolidation of Erste Bank (one of Austria's largest savings banks and parent of Erste Group). Their financial statements are fully consolidated by Erste Bank, even though Erste Bank does not own any stake in some of them. Erste Bank exerts control over all members of the IPS according to two cumulative criteria: it controls the steering entity[33] and the steering entity has the ability to influence the savings banks' variable returns[34]. Similarly, within RZB Group[35], the Raiffeisen mutual banks are fully consolidated and included in the consolidated supervision of the parent company.

Relaxed liquidity requirements resulting from liquidity pooling

The short-term liquidity coverage requirement (LCR) and the long-term liquidity requirement (NSFR) are also relaxed[36]. The derogations allowed are similar to those available to institutions affiliated to a central body (see

table 2). Given that intra-network transfers are vital to the network's operation (due to the distribution of roles, statutory minimum deposit obligations and any other arrangements), these commitments receive particularly favourable treatment. Our feeling is that the regulator is attaching more importance to task-sharing (and the fact that one or more institutions in particular are pooling liquidity) than to mutual support promises. This is shown by the assumption that off-balance sheet commitments (credit and liquidity facilities) between members of the same network would be less likely to be used, even in the event of market tension. In our view, that assumption is at odds with the mutual support system. That system implies that, if difficulties arise, the use of those commitments would actually be higher, and would give rise to larger outflows of liquidity for the creditor bank if its counterparty is a member of the same IPS. When a member applies a lower outflow rate for undrawn credit or liquidity facilities, a corresponding symmetric or more conservative inflow rate is applied by the counterparty.

Major contribution to financing the economy

We propose taking the regulator's point of view and providing a "consolidated" view of German institutional protection schemes (which assumes that these IPSs also have cross-guarantee schemes like that of Austria's Erste Group, see above). This wider view allows us more effectively to assess their financial characteristics and contribution to financing the economy. Based on available information, a rigorous consolidation of the balance sheets and income statements of the 580 S-Group members or the 1,033 institutions taking part in the protection scheme overseen by BVR is, of course, not really conceivable. DSGV publishes aggregate financial statements for the main members of S-Group and BVR publishes consolidated financial statements for members of the co-operative financial group, but those reports are not available pre-2007. To provide a longer-term view, and based on Bundesbank statistics and simplifying assumptions (particularly in order to eliminate intra-network exposures), we propose aggregating the accounting items of the Sparkassen and Landesbanken on the one hand, and the co-operative banks and their central institutions on the other (see box, page 17). We assess the market shares of the two networks, their contribution to financing the German economy and their overall returns on equity.

As we mentioned in the introduction, IPSs have considerable importance in Germany. The two German IPSs account for 76% of credit institutions established in Germany, 36% of aggregate bank assets (33% excluding intra-network exposures, see chart 1) and more than half of loans granted to German households and non-financial companies. S-Group in particular dominates lending to households and non-financial companies, along with deposits from households, but also lending to the Länder and local authorities (charts 2 and 3). Both networks show loan/deposit ratios of less than 1.

In general, the network of co-operative banks makes a stable contribution to growth in lending, moderate in the case of loans to non-financial companies but higher in the case of loans to households (charts 4 and 5). The contribution of the S-Group is more variable: at the group level, the stability of funding offered by the Sparkassen mitigates the reduction in the Landesbanken's loans outstanding. By comparison, the stabilising effects arising from the close ties that savings banks and Raiffeisen co-operative banks have with their customers can also be seen in Austria (chart 6).

Although S-Group's net interest margin (the net interest income of the Sparkassen and Landesbanken divided by the average "consolidated" assets of those two groups of institutions) is lower than those of the savings banks taken in isolation, it is higher than those of private-sector commercial banks (chart 7, page 16). The gap has widened since 2007, since members of the public-sector network have benefited from a much larger drop in the cost of their resources (because of a more favourable liability structure, with non-bank customer deposits accounting for 60% of S-Group's liabilities, and an increase in the relative weight of demand deposits). The mutual network also enjoys comfortable net margins, although they are gradually declining in the current low-interest-rate environment.

3/4 of German credit institutions are members of an IPS

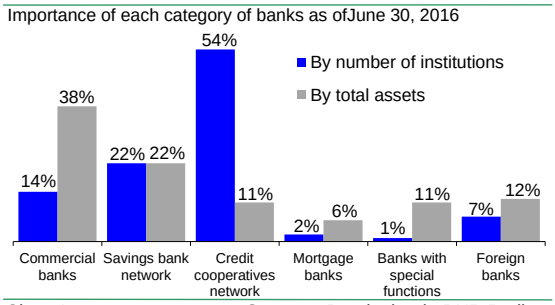


Chart 1 Sources: Bundesbank, BNP Paribas

Loans to non-financial companies: stabilising effects less visible at the S-Group level...

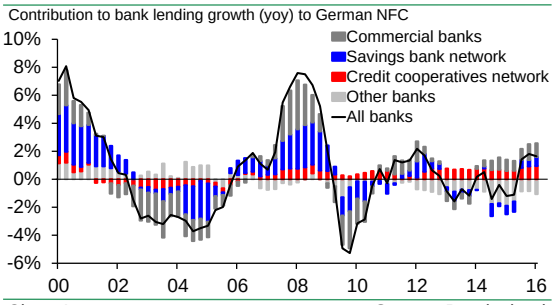


Chart 4 Source: Bundesbank

IPSs dominate the household savings and loans segment

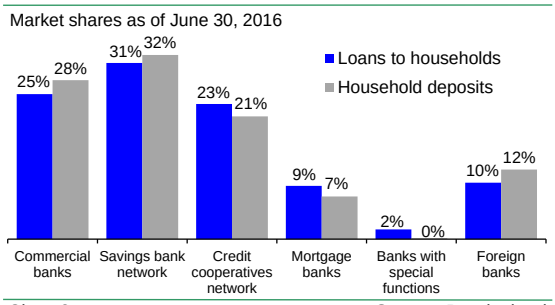


Chart 2 Source: Bundesbank

...and a similar story for household loans

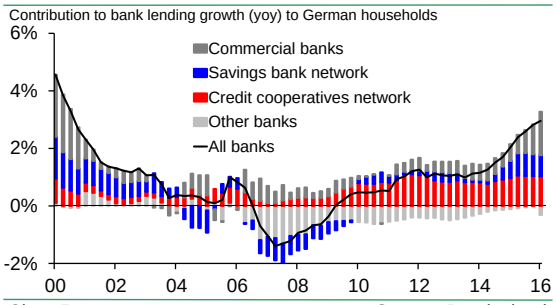


Chart 5 Source: Bundesbank

S-Group is a key partner for businesses

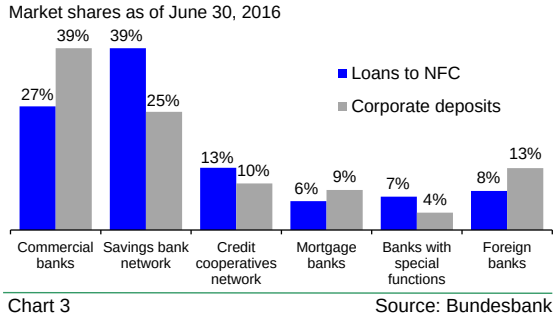


Chart 3 Source: Bundesbank

Stabilising effects at Austrian IPSs as well

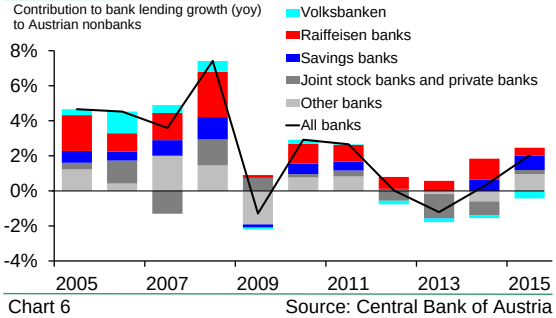


Chart 6 Source: Central Bank of Austria

German IPSs post comfortable net interest margins (%)

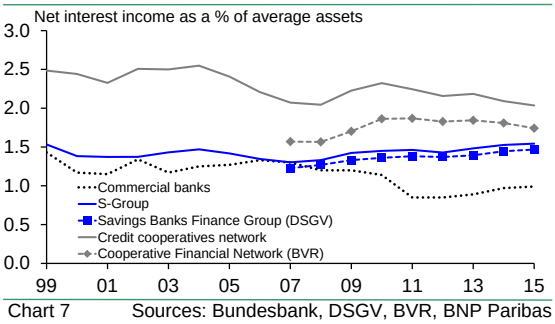


Chart 7 Sources: Bundesbank, DSGV, BVR, BNP Paribas

Cost of risk by category of banks (%)

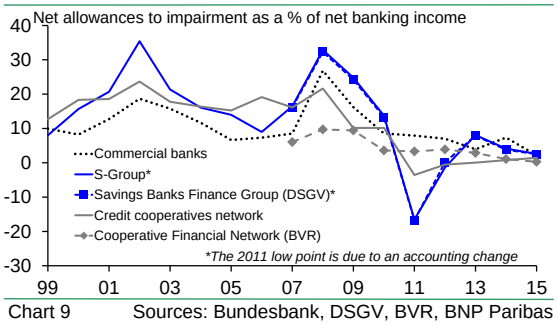


Chart 9 Sources: Bundesbank, DSGV, BVR, BNP Paribas

Cost to income ratios by category of banks (%)

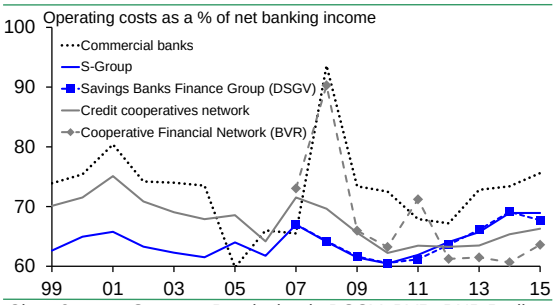


Chart 8 Sources: Bundesbank, DSGV, BVR, BNP Paribas

German IPSs coped well with the shock resulting from the financial crisis (%)

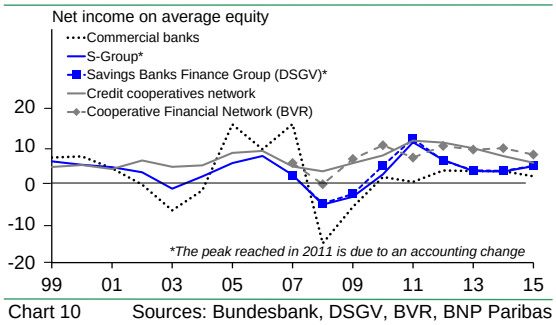
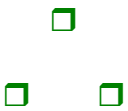


Chart 10 Sources: Bundesbank, DSGV, BVR, BNP Paribas

Cost/income ratios reflect the comfortable margins the networks generate from their business and appear more sustainable than those of private-sector commercial banks (chart 8). Within S-Group, however, post-crisis cost-cutting efforts have faded and cost/income ratios have risen to their 2007 levels, mainly because of lower net banking income from the Landesbanken. Cost of risk at the two networks is relatively close to the German bank average (chart 9).

In contrast to the Sparkassen's very stable RoE, the Landesbanken suffered serious losses between 2007 and 2009. At the S-Group level, the positive effects of diversification came into play: the recurring revenue generated by the Sparkassen allowed the group to absorb defaults arising from the economic downturn and cope with losses suffered by the Landesbanken on their risky exposures [37] (chart 10). Over the observation period, the mutual network's return on equity was very solid, although some members or subsidiaries of the network that are not covered by our analysis experienced difficulties in 2008 and 2011, dragging down the network's overall RoE (the dips only show up in the financial statements prepared by BVR). Without question, the networks benefited from the good quality of their domestic loans and the availability of a large base of stable resources (especially since depositor confidence in deposit guarantee systems, and in the German state, removed any risk of a bank run).

As a result, the consolidation of the financial statements of local banks and of their central institutions shows that S-Group and the co-operative group had a higher ability to absorb losses, at the time of the financial crisis, in comparison with certain private-sector commercial banks. However, ongoing low interest rates may increase liquidity transformation risk and drag down bank earnings. The shipping finance commitments of certain Landesbanken are also a source of concern. By comparison, in Austria, savings banks and the Raiffeisen and Volksbanken co-operative banks, regarded as a whole, also show much higher net margins and lower cost/income ratios than other Austrian banks. However, their average RoE is fairly close to that of their rivals, because of lower loan quality.



Although they are not consolidated banking groups from the strictly accounting point of view, it could be said that institutional protection schemes form "flexible" groups. Given their importance in the eurozone, they require an appropriate regulation and supervision framework, particularly in view of banking union.

At the aggregate level, an IPS may meet the specific regime established by the European directive on recovery plans, and its members may be exempted from it. It may also be recognised as a deposit guarantee system, exempting its members from having to contribute to a national guarantee fund. However, no IPS is considered as a group as part of the identification of "significant" institutions by the single supervisor or of global or even domestic systemically important banks.

The regulation and supervision of IPSs requires close co-operation between the regulator, single supervisor and competent national authorities. Numerous provisions of the European legislation applicable to IPSs are left to the discretion of national supervisors. In addition, IPSs generally consist of some institutions under the direct supervision of national authorities and others under the direct supervision of the ECB. This framework must maintain as effectively as possible the benefits of this type of mutual support network in countries where they are established, as well as limiting the risks that they could pose for financial stability. The creation of institutional protection schemes is a judicious response to the dispersed nature of local banks or co-operatives. They offer both the advantages of a network (sharing the same brand, pooling certain functions, achieving economies of scale and scope) and those arising from intra-network mutual support (diversifying risk, reducing financing costs), while maintaining the autonomy of their members. To some extent, an IPS' business model is similar to that of a universal bank, albeit one that is incomplete because it is not integrated. However, the creation of IPSs also increases the interconnections between the hundreds or thousands of banks belonging to these networks. That may have prompted the ECB to increase the reporting obligations of IPSs.

Writing completed on 1 December 2016
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Box

Scope of consolidation and method used to eliminate commitments within German IPSs

The Bundesbank provides annual balance sheets and income statements by type of institution (savings banks, regional public banks, building societies, credit cooperatives, central institutions of credit cooperatives, private-sector commercial banks etc.), but only on a non-consolidated basis (aggregation of non-consolidated financial statements). These data cannot be reconciled with the scope of the two German networks. For example, in the Bundesbank's statistics, the assets of the Landesbausparkassen, which are members of S-Group, are aggregated with those of other building societies. In addition, interbank receivables and payables are not broken down by counterparty, which means that any intra-network exposures cannot be assessed. At our request, however, the Bundesbank has provided unpublished monthly data sets since 1999 relating to loans and deposits between Sparkassen and Landesbanken and between mutual institutions and their central banks. These figures show that local banks are net debtors (in the loan segment alone) to their central institutions, and they show the scale of intra-network interbank exposures (charts 11 and 12). However, there are no statistics that enable us to assess the amount of debt securities issued by the central institutions and held by the local banks.

More than 40% of the Sparkassen's interbank loans are to Landesbanken

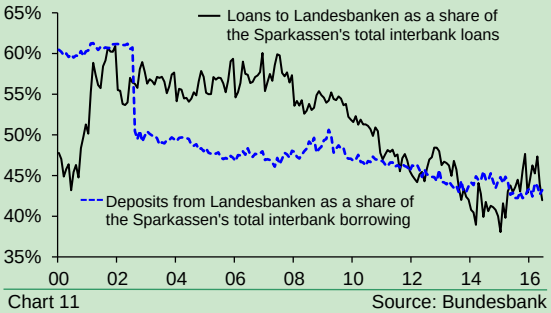


Chart 11 Source: Bundesbank

Almost 90% of cooperative banks' interbank loans are to DZ Bank and WGZ Bank

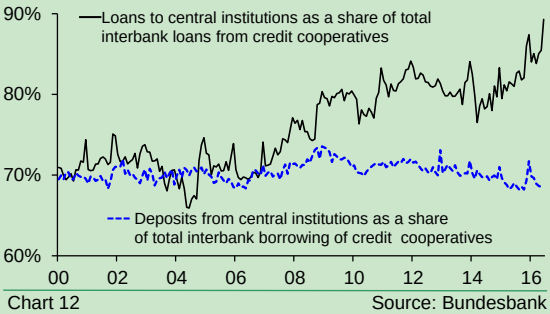


Chart 12 Source: Bundesbank

We have made some simplifying assumptions:

- As regards S-Group, we have only "consolidated" the financial statements of the Sparkassen and Landesbanken (their aggregate assets accounted for 75% of S-Group's total business volume at end-2015); for the co-operative network, we have "consolidated" the financial statements of the co-operative banks and of DZ Bank and WGZ Bank, their central institutions (95% of consolidated assets). Like the Bundesbank and DSGV, we have not taken into account foreign branches, national subsidiaries and foreign subsidiaries of the Landesbanken, DZ Bank and WGZ Bank.

- We have assumed that exposures between banks or between central institutions are negligible and take the view that the aggregate balance sheets of the four types of institution are a good proxy for their respective consolidated balance sheets.

- We have no statistics on the outstanding debt securities issued by the central banks and held by the local banks. While local banks are net borrowers on the interbank loan market, particularly from their central institutions (confirmed by the file sent to us by

the Bundesbank), the Bundesbank regularly states in its reports that their ownership of debt securities gives them an overall net creditor position. Ehrmann and Worms (2004) have noted that, in the 1990s, three quarters of local savings banks' receivables were owed by their central banks, rising to 92% for credit cooperatives[38]. We have applied these proportions to the total interbank receivables of savings banks and mutual banks at 31 January 1999. From the resulting amount, we have calculated the loans made by local banks to their central institutions (on the same date) in order to determine the amount of debt securities issued by the central institutions and held by the local banks.

At 31 January 1999, we see that 80% (64%) of amounts receivable by savings banks (credit cooperatives) from their central institutions consisted of debt securities, which means that 20% (36%) were in the form of loans. On our estimates, those securities represent 84% (100%) of the bank debt securities portfolio held by savings banks (credit cooperatives). We have arbitrarily set that proportion at 80% (100%) between February 1999 and today. From that assumption, we have calculated the amount of debt securities issued by the central banks and held by the local banks. We have added interbank loans and obtained the total amounts receivable by local banks from their central institutions at each date. Based on that assumption, more than 70% of the amounts receivable by the Sparkassen from the Landesbanken consisted of debt securities in June 2016 (versus 80% in 1999), falling to 56% for mutual institutions (versus 64% in 1999). Overall, 65% of the Sparkassen's interbank receivables are owed by their central institutions (versus 75% in 1999), rising to 95% (versus 92% in 1999) within the cooperative network (charts 13 and 14).

S-Group: central institutions remain the main debtors of local banks

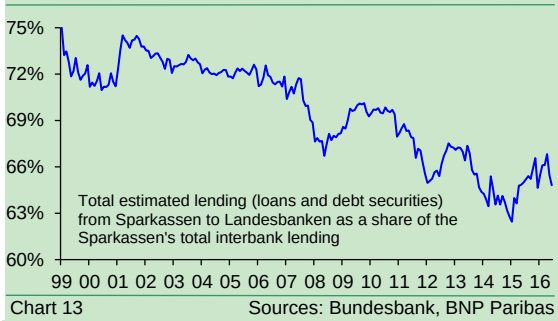


Chart 13 Sources: Bundesbank, BNP Paribas

The same is true within IPSs of cooperative banks

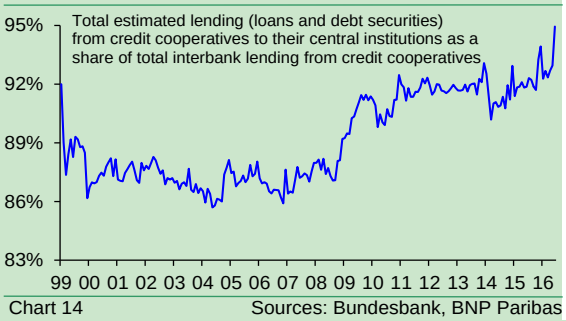


Chart 14 Sources: Bundesbank, BNP Paribas

After netting of intra-network commitments, the aggregate balance sheet of the Sparkassen and Landesbanken is reduced by 10% (on average over the period) and that of credit cooperatives by 20%. In June 2016, on our assumptions, S-Group's "consolidated" total assets amounted to EUR 1,933 billion and that of the cooperative network to EUR 949 billion. By comparison, Deutsche Bank had total assets of EUR 1,803 billion and Commerzbank EUR 533 billion. These figures challenge, to some extent, the supposed lack of concentration in the German banking industry.

Every year, using Bundesbank statistics and financial statements published by institutions, DSGV prepares an aggregate balance sheet and an aggregate income statement for savings banks, regional public banks (excluding foreign branches and domestic and foreign subsidiaries), and regional building societies. BVR, meanwhile, prepares consolidated financial statements covering all members of the co-operative network. The reports available on both associations' websites cover the 2007-2015 period. The net margins, cost/income ratios and RoEs resulting from DSGV's aggregation are very similar to those we obtained after consolidating the financial statements of the Sparkassen and Landesbanken. However, differences in scope explain why our observations differ from those of BVR; we are unable, based on the Bundesbank's aggregate figures, to capture the domestic and foreign subsidiaries of credit cooperatives and their central institutions.

Source: BNP Paribas

NOTES

[1] *Bulbul D., Schimdt, R. et Schuwer, U. (2013), Caisses d'épargne et banques coopératives en Europe, Revue d'économie financière, no. 111.*

[2] *As well as tax benefits.*

[3] *According to this rule, an institution's exposure to any client or group of clients cannot exceed 25% of its eligible own funds.*

[4] *Institutions with total assets of over EUR 30 billion or whose total assets equal over 20% of its country's GDP.*

[5] *The examination carried out by the authorities is based on all aspects covered by the conditions and assessment criteria established by the CRR, additional information obtained during ongoing supervision of institutions forming part of the IPS, and a comparison with other existing IPSs.*

[6] *An IPS organised at the national level may contain several regional IPSs.*

[7] *https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/institutional/2016-03-31_ips_public_hearing_presentation.pdf*

[8] *https://ec.europa.eu/transparency/regdoc/rep/1/2015/EN/1-2015-388-EN-F1-1.PDF*

[9] *http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0575&from=FR*

[10] *http://eur-lex.europa.eu/legal-content/FR/TXT/PDF/?uri=CELEX:32015R0061&from=EN*

[11] *https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/reporting/ecb_guide_options_discretions.en.pdf?59277660d00228705435a3ab8627afe7*

[12] *https://www.bankingsupervision.europa.eu/ecb/pub/pdf/institutional_protection_guide.en.pdf*

[13] *See Schackmann-Fallis K.-P. (2008), Les Sparkassen, facteur de stabilité pour l'économie allemande, Regards sur l'économie allemande, Bulletin économique, no. 88.*

[14] *Depositors at institutions that are members of these institutional protection schemes have a statutory right to compensation.*

[15] *Thus, within a banking group, the authorisation to derogate from capital requirements (article 7(1) CRR) and liquidity requirements (article 8(1) CRR) on an individual basis can only be granted if the parent company meets the obligations set out on a consolidated basis, if it guarantees the commitments made by the subsidiary or subsidiaries obtaining the derogation, and if it holds more than 50% of their voting rights.*

[16] *Central bodies (such as Crédit Agricole S.A. for the Crédit Agricole group, BPCE S.A. for the BPCE group and Confédération Nationale du Crédit Mutuel for the Crédit Mutuel group in France) represent the network with respect to the public authorities, and defend and promote its interests. They are tasked with ensuring the cohesion of their networks and ensuring that the credit institutions affiliated to them run smoothly. They define the group's policy and strategy, and co-ordinate commercial policies within the network. They ensure compliance with legislative and regulatory provisions within their network, and they exert administrative, technical and financial control over the regional banks. They ensure the quality of affiliated institutions' financial position, particularly through on-the-spot checks. Through the statutory mechanism of internal financial mutual support, they must also take all necessary measures to ensure the liquidity and solvency of the network as a whole and of each institution affiliated to them (including the central body). To that end, they determine the group's liquidity management rules and create a guarantee fund, defining its rules of operation and intervention arrangements as well as the contributions of affiliated institutions (initial and top-up contributions). The central body may have the status of a société anonyme (French joint-stock corporation) that is also a credit institution (Crédit Agricole S.A., BPCE S.A.), or the legal form of an association with collective authorisation, provided that certain governance principles are met (CNCM).*

[17] *The authorities have a margin of appreciation. This is shown by the ECB's view that the IPS should have "the possibility to influence the risk situation of the IPS member institutions by issuing instructions, recommendations, etc. to them, to restrict certain activities or to require a reduction of certain risks, for example".*

[18] *In Germany, Sparkassen-Finanzgruppe Hessen-Thüringen, made up of Landesbank Helaba (88%-owned by the German association of savings banks in Hesse and Thuringia and owner of Frankfurter Sparkasse) and 50 savings banks in its area, is a unique model of integration between a Landesbank and Sparkassen. This "S-Group" publishes consolidated financial statements each year, on a voluntary basis because its members remain autonomous. However, the association of German savings banks (DSGV) opposes widespread vertical integration of savings banks and German regional public banks, because that would damage the key strength of the Sparkassen-Finanzgruppe, i.e. its polycentrism.*

[19] *In January 2016, Arkéa successfully asked the Paris Regional Court to cancel the change in CNCM's status to that of a co-operative company. In August, Arkéa was authorised by the Rennes Administrative Court to not pass on prudential information, which would have been useful in establishing the group's preventive recovery and resolution plans, to the group's central body. After the Conseil d'Etat and the Paris Regional Court, the European Union recognised the validity of the Crédit Mutuel brand, which CNCM owns on behalf of the whole Crédit Mutuel group. In September, the Paris Administrative Court rejected Crédit Mutuel Arkéa's claims, reaffirming the validity of the territorial principle. To meet the ECB's requirements, the group put to the board of directors a draft clarification of the internal mutual support mechanism, and reiterated that, in law, CNCM was the group's central body and therefore the preferred point of contact for the single supervisor. Given that CNCM could not guarantee impartiality or independence (with respect to the inter-federal bank CM11 in particular), Arkéa opposed the initiative, calling for the creation of several central bodies within the group.*

[20] *Controlled companies are fully consolidated. Full consolidation consists of eliminating the value of the shares held by the parent company and replacing it with a value for each asset and liability of its subsidiaries. Where the group carries out an activity with one or more partners and where control is shared under a contractual agreement that requires decisions relating to relevant activities (i.e. those that materially affect the entity's returns) to be taken unanimously, the group has joint control over the activity. Where the jointly controlled activity is carried out via a distinct legal structure to whose net assets the owners of the joint arrangement are entitled, that joint venture is accounted for under the equity method. The equity method consists of eliminating the value of the shares and replacing it with the Group's share of the equity and income of the companies concerned. Where the jointly controlled activity is not operated via a distinct legal structure or the owners of the jointly controlled activity have rights over its assets and obligations with respect to its liabilities, the group recognises its assets, liabilities and its share of income and expenses according to the applicable accounting standards. Companies over which a group has significant influence, known as associates, are accounted for under the equity method. Significant influence is the power to engage in the financial and operational decisions of an entity without controlling it. Significant influence is assumed if the group holds, directly or indirectly, 20% or more of an entity's voting rights.*

[21] *The prudential scope defined for the consolidated supervision of regulatory ratios is identical to the accounting scope; the only thing that changes is the consolidation method for insurance subsidiaries, jointly controlled companies and certain special-purpose entities. Insurance companies are accounted for under the equity method within the prudential scope, regardless of the accounting consolidation method. Jointly controlled entities, which were proportionally consolidated for accounting purposes at 31 December 2013 and now equity-accounted in accordance with IFRS 11, remain proportionally consolidated for prudential purposes. Disposals of assets or assignments of risks are assessed in view of the type of risk transfer that results. Securitisation vehicles are excluded from the prudential scope to the extent that the securitisation transaction concerned allows a significant transfer of risk.*

[22] *The consolidated financial statements of Confédération Nationale du Crédit Mutuel (central body of the Crédit Mutuel group) and of BPCE S.A. (central body of the BPCE group) only include the financial statements of their respective subsidiaries, since the banks (their affiliates) do not contribute to the earnings of those central bodies.*

[23] *The banks owned a majority stake in Crédit Agricole S.A. through SAS Rue de la Boétie (which is still the case). Since Crédit Agricole S.A. is stockmarket-listed, SAS Rue de la Boétie had the explicit purpose of holding enough shares for it to own more than 50% of Crédit Agricole S.A.'s capital and voting rights (it owned 56.7% of Crédit Agricole S.A.'s capital, with the other 43.3% owned by Crédit Agricole S.A. itself, its employees and investors external to the network). Meanwhile, Crédit Agricole S.A. owned 25% of the capital (without voting rights but with rights to net assets) of each regional bank (with the exception of the Corsica regional bank which was wholly owned by CASA). The central body consolidated the financial statements of the group's regional banks under the equity method. This cross-shareholding arrangement was abolished by the "Eureka project". Through that project, Crédit Agricole S.A. sold its stakes in the regional banks to a holding company (Sacam Mutualisation), which is jointly owned by all of the regional banks. The project was part of an effort to simplify the group's ownership structure in the eyes of the market and single supervisor, to strengthen and improve the quality of CASA's capital base (allowing it to pay dividends in cash) and to increase the pooling of the regional banks' earnings. The more comprehensive reform that was initially put forward was to create a genuine group parent company, to which the regional banks would have been attached and which would have owned 100% of the group parent, along with a listed "new CASA" bringing together the group's business lines and subsidiaries. Central functions and the role of central body, currently handled by CASA, would have been handled by the group parent. However, the reform would have been blocked by the ECB's refusal to grant the group IPS status. Without that status, the capping rules on non-controlling interests in CASA would have reduced the group parent's solvency.*

[24] *As with conventional groups, the scope of consolidation of a group with a central body for prudential supervision purposes is similar to the accounting scope, barring factors such as the consolidation method used for insurance companies.*

[25] *Regardless of the accounting method selected, the multiple use of elements eligible for the calculation of own funds and any inappropriate creation of own funds between the members of the IPS is forbidden (article 113(7)(g) CRR).*

[26] *Similarly, commitments between institutions that are members of the same IPS should be capable of being excluded from the calculation of exposure with respect to leverage (denominator of the leverage ratio). However, the delegated regulation only provides for such a derogation for institutions that meet all conditions set out in article 113(6) CRR, whereas members of an IPS do not meet them.*

[27] *That exhaustive requirement does not appear to be an inconvenience, provided that the proportion of the assets covered by the analysis is material. For example, the association of German savings banks, DSGV, which oversees an IPS comprising 580 companies and associations (the S-Group), prepares an aggregate balance sheet and income statement each year for the main members of the IPS alone (at 31 December 2015, 413 savings banks, 7 regional public banks, an asset manager and 9 regional building societies, i.e. 430 institutions accounting for 80% of S-Group's on-balance-sheet assets and assets under management).*

[28] *At least every half-year from June 2017.*

[29] *The association of co-operative banks, BVR, publishes a report once a year comprising a consolidated balance sheet and a consolidated income statement, along with capital ratios based on an extended aggregate calculation. The association of savings banks, DSGV, is not as explicit as the BVR on the matter, but publishes aggregate financial statements once a year along with aggregate Tier 1 capital ratios (based on the financial statements of the Sparkassen and Landesbanken).*

[30] *Minority interests refer to the proportion of equity instruments or net income of fully consolidated subsidiaries that belong to minority shareholders in those subsidiaries and not to the parent company (interests outside of the institution's prudential scope of consolidation).*

[31] *At the consolidated level, paid-up capital and reserves set aside for the support fund are recognised as own funds within the meaning of the CRR.*

[32] *Effective since 1 January 2014.*

[33] *Erste Bank holds, directly or indirectly, at least 51% of the steering entity's voting rights (so the stake held by other savings banks in the structure's capital is capped at 49%).*

[34] *The steering entity takes part in actions such as appointing board members, approving budgets including capital decisions and the payout of dividends, defining binding guidelines in the areas of risk and liquidity management, and carrying out internal audits.*

[35] *In October, the group's management boards and supervisory boards approved a merger between parent company RZB and its listed subsidiary RBI. The resolution must be approved with a 75% majority in an extraordinary general meeting of shareholders, scheduled for 24 January 2017. The transaction aims to simplify the group's structure and strengthen the group parent's solvency.*

[36] *LCR requirements mean that banks must hold enough unencumbered high-quality, liquid assets to deal with net liquidity outflows caused by a serious crisis lasting 30 days. In some conditions, members of an IPS may be authorised to derogate from the strict application of liquidity standards on an individual basis. In that case, the relevant authorities supervise it as a specific liquidity sub-group and designate one of the exempted institutions as the one that must meet requirements on the basis of the consolidated situation of all institutions in the liquidity sub-group (article 8(4) CRR). In our view, the conditions attached to this derogation go against the main reason for institutions to belong to an IPS, which is to maintain their independence. The conditions assume that one of the institutions is able to supervise the liquidity positions of each member, and that there is an internal system for managing and mitigating liquidity risk for the whole network. Without that derogation, an IPS can benefit from advantageous arrangements for calculating liquidity inflows and outflows under the LCR. The Commission also recommends that, for the calculation of the NSFR, the coefficients applied to transactions between members of the same IPS (as with members of the same banking group) be identical. See Stern, T. (2014), Regulating Liquidity Risks within Institutional Protection Schemes, Beijin Law Review, no. 5.*

[37] *The unfailing support provided by the regions to the Landesbanken also allowed S-Group to avoid booking heavy losses.*

[38] *Ehrmann M. and Worms A. (2004), Bank networks and monetary policy transmission, Journal of the European Economic Association, vol. 2, no. 6, p. 1148-1171.*

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