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EBA CONSULTATION PAPER

DRAFT REGULATORY TECHNICAL STANDARDS ON THE IDENTIFICATION OF A GROUP OF CONNECTED CLIENTS UNDER POINT 39 of ARTICLE 4.1 OF REGULATION (EU) NO. 575/2013

REQUEST FOR CLARIFICATIONS ON THE LINKS BETWEEN GENERAL PARTNERS - SGR - FUNDS – SUBSIDIARIES

EBA/CP/2022/07 - Question 2

Have you identified any additional aspect(s) that would require clarification? In this vein, would you see the need for further illustrative examples (and if yes, on which precise situation or specific case)? Please elaborate.

Intesa Sanpaolo (ISP) welcomes the consultation on the draft RTS on the identification of a group of connected clients. With reference to question 2 we believe that further clarification regarding the links between General Partners - SGR - Funds – subsidiaries would be very beneficial to market participants as it is not disciplined in the draft RTS nor in the EBA Guidelines (GL). Please find here below our description of some specific situations that in our opinion would require further clarification.

We specifically believe that the relationship between General Partners / SGRs and Funds they manage as well as between Funds (including Private Equity Funds) and their related companies (SPVs / subsidiaries) deserve further explanation.

This document is divided into 2 sections:

- **SECTION 1** provides some specific cases - supported by graphical examples - aimed at representing situations deserving further investigation,

- **SECTION 2** provides a proposal containing some criteria that Intesa Sanpaolo consider could be used to demonstrate the absence of a single risk between the aforementioned Funds and their related companies (referred to below as "portfolio companies").

In connection with the topics illustrated under these two sections, we request the guidance of the EBA.

SECTION 1

We hereby illustrate three different concrete examples of possible clients of a bank using Fund Funds/SPV and companies.

Example 1

Fund 1, managed by GP A, is investing - through an SPV (SPV A) – with 100% interest (or, generally speaking holding the majority of the shareholders' or members' voting rights) in Company A. Fund 1 through a different SPV (SPV B) invests in Company B, again with 100% participation (or, generally speaking, holding the majority of the shareholders' or members' voting rights).
The two companies are separate, independent and have no connection between themselves. Each "shareholding" of the Fund passes through SPVs that are isolated from each other and from the Fund hence a company liquidation does not automatically trigger a liquidation of the Fund or an event of default, rather it would entail a reduced return for the Fund. In addition, the Fund liquidation event would not automatically lead directly to an insolvency procedure for any of the companies owned by it as the investments are bankruptcy remote (no downstream / upstream dependence).

Please see below a graphic presentation for this example 1 with clear indication of ISP clients/counterparties: as per the example below, ISP clients would be Company A and SPV A, Company B and SPV B. Each one is funded through bankruptcy remote structures isolated from each other.

Based on the EBA guidelines (GL), section "Establishing interconnectedness based on economic dependency" in the light of the situation above the downstream or upstream contagion would be limited between Company A and SPV A on one side and, separately Company B and SPV B. Since ISP clients would be Company A and SPV A, Company B and SPV B and each shareholding of the Fund passes through SPVs that are bankruptcy remote structures isolated from each other, our concrete approach would be to consider a group at the level of each SPV (Group 1 including only SPV A and Company A, Group 2 including only SPV B and Company B; Fund 1 would result as separated from the two SPV, therefore no group with Fund and / or GP A[1] would be considered, see Figure 1): could you please confirm the correctness of our approach?

Could you also please confirm that a similar approach is feasible also in case there is no SPV and therefore Fund 1 is directly connected with Company A and Company B; in fact, we consider that also in such case company A or B liquidation would all be treated as stand alone from a credit risk perspective.

Could you kindly confirm such approach (please see figure 1a)?

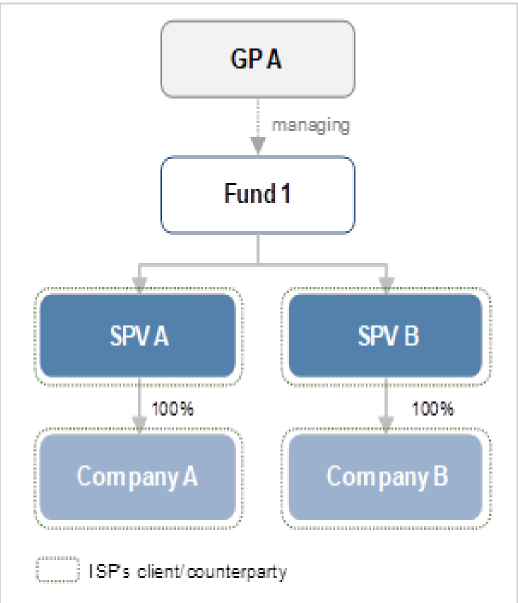

Figure 1

1 Cases where the applicable local regulatory framework for the relevant entities (i.e. link between GPs and their managed funds) already provides for segregation are outside the scope of this paper.

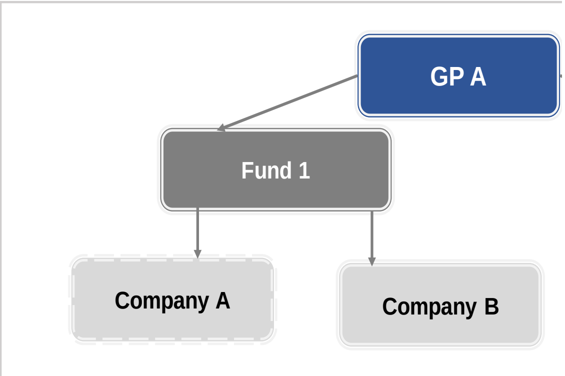

Figure 1a

Example 2

Fund 1, managed by GP A, is investing through SPV X with 100% interest (or, generally speaking, holding the majority of the shareholders' or members' voting rights) in Company A. Fund 2, managed by the same GP A invests through a different SPV Y in Company B, again with 100% participation (or, generally speaking, holding the majority of the shareholders' or members' voting rights).
The two Companies A and B are separate, independent and have no connection between themselves. Please see below a graphic representation for this example 2 with clear indication of ISP clients/counterparties:

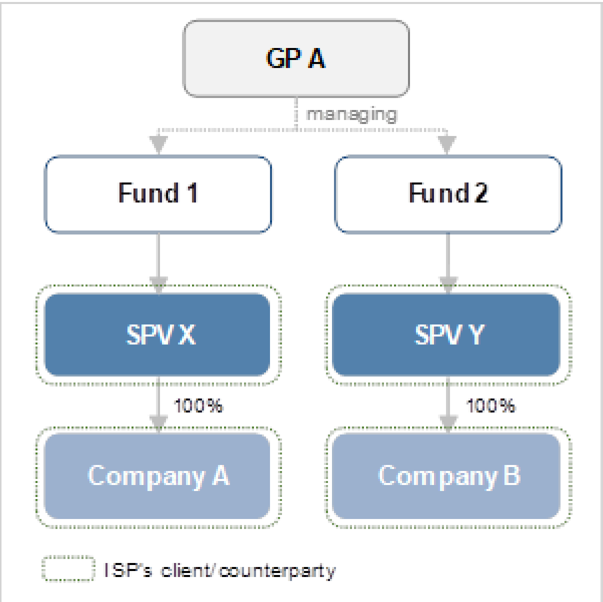

Figure 2

ISP Orientation
In this case, SPV X and Company A should be connected (as well as SPV Y and Company B, but in a separate group) with each shareholding of the Fund passing through SPVs that are isolated from each other (bankruptcy remote structures).
In our opinion we should exclude GP A, Fund 1 and Fund 2 from the definition of connected customers, since there is no risk of contagion among them [in line to what stated in the Example 1 [and example 1a].

Based on the guidelines, section "Establishing interconnectedness based on economic dependency" it appears that only SPV X and Company A should form a group, as well as Company B and SPV Y. Furthermore, the fund has developed a bankruptcy remote structure to fund each investment, hence no recourse to the fund would be available in addition to the equity already invested. In addition, the Fund could not utilize any return obtained from Company B to eventually sustain Company A as it would have to return all income received to its relative LPs (Lp of each fund do not coincide hence cannot be freely exchanged).

Again, there is no chain of dependency above SPV X and SPV Y, in line with the aim of establishing bankruptcy remote structure for each investment.

In this case our orientation would be to form Group of connected clients at SPV level (e.g (Group 1 including only SPV X and Company A and Group 2 including only SPV Y and company B).

Could you please confirm the correctness of our approach?

Example 3

Fund 1, managed by GP A, is investing through an SPV with 100% interest (or, generally speaking, holding the majority of the shareholders' or members' voting rights) in Company A. Subsequently, Company A buys a majority interest in the capital of another company, Company B. The two companies become part of a single group.
The two companies become part of a group. Please see below a graphic presentation for this example 3 with clear indication of ISP clients/counterparties:

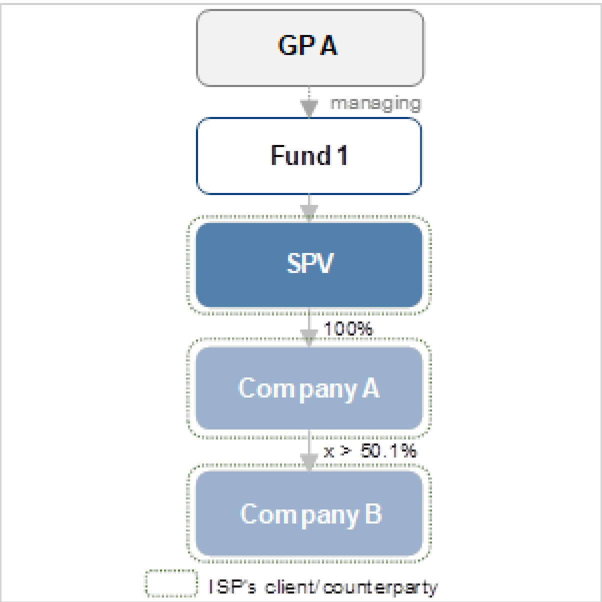

Figure 3

In this case the SPV, Company A and Company B are connected clients and create a group. They will publish consolidated financial statements and will fall within the definition of single risk as there is a strong assumption that a contagion risk is existing because of the economic and controlling relationship among them.

GP A and Fund 1 made their shareholding of the Fund passing through bankruptcy remote structures SPV is isolated from the fund. There is no down or upstream dependency given the bankruptcy remote structures in place.

Based on the guidelines, section "Establishing interconnectedness based on economic dependency" the group of connected customers should be set at the SPV level as the risk of contagion and financial dependency stops there. As a matter of fact, upstream and downstream is limited to Company A, Company B and the SPV but it does not extend to Fund 1 and GP A for the same reasons we said before under example 1 and 2. Therefore the Group would only include only SPV, Company A and Company B.

Could you please confirm the correctness of our approach?

SECTION 2

Here below we propose some criteria that Intesa Sanpaolo would follow to demonstrate the absence of a single risk between the aforementioned Funds and their associated companies (referred to below as "portfolio companies").

This, consistent with document EBA/GL/2017/15 - Final Report - Guidelines on Connected Clients under Article 4 (1) (39) of Regulation (EU) No. 575/2013 - in which it was pointed out that:

- although institutions should first assume that customers with a controlling relationship with each other constitute a unique risk, it is possible for institutions to disprove this assumption by showing that there is no unique risk despite the controlling relationship. In this vein, the Final Report helpfully points out that the assessment of a control relationship "*is only the first step in the assessment of the connections among clients, before assessing any potential economic dependency*" (see 2.2.1(11) of the Final Report – p. 8).
- "*institutions are responsible for demonstrating to competent authorities, and documenting appropriately, that in a specific case a control relationship among clients does not lead to the existence of a single risk and, therefore, to a grouping requirement on the basis of control*" (see p. 51)

Proposed criteria for assessing the absence of single risk

Case 1 - assessment of the possible contagion of the portfolio company by the Fund suffering financial stress.

a) Since the Fund's initial investment in the portfolio company, there have been no frequent capital increases.

   If this requirement is verified, this means, in our view, that the Fund is operating correctly and in accordance with its mandate, i.e. avoiding injecting additional liquidity in the face of possible difficulties of the portfolio company, which is normally assessed individually for its ability to generate income, without recourse to guarantees or new financing from controlling shareholders.

b) Any balance sheet liabilities of portfolio companies are represented, for example, by bond issues or loans received involving third parties other than the Fund

   If this requirement is verified, this means, in our view, that the obligations of the portfolio company are unrelated to those of the controlling entity (Fund), which, by its nature, is typically required to invest a maximum share of its assets in each individual target and therefore does not normally exceed these concentration limits, by providing additional liquidity to the portfolio companies in addition to the initial allocation.

c) The Fund does not own - through a chain of ownership separate from that of the "portfolio company" concerned - other subsidiaries with which the "portfolio company" itself has business synergies (e.g. within the same industrial sector), with the result that the Fund together with all its subsidiaries is not to be regarded as a single industrial group.

If this requirement is verified, this means, in our opinion, that the Fund is operating according to a correct logic that identifies it as a pure investment vehicle that aims at an adequate diversification (sectoral and/or geographical) in the interest of its participants and whose other investments do not present the same degree of correlation with each other, as is the case in an industrial group. In an industrial group, in fact, the subsidiaries generally all operate in the same sector of activity or cooperate, each in its own role, in the production of goods and services that represent the group's core business, so that if one of them encounters financial difficulties, the others will most likely suffer as well (domino effect).

Case 2 - assessment of the possible contagion of the Fund by the portfolio company (controlled entity) suffering financial stress

a) The Fund has a relatively large and diversified portfolio in which the relative weight of each portfolio company (concentration limit) does not exceed a certain threshold, e.g. 20%.

   If this requirement is verified, this means, in our opinion, that the impact on the Fund of any financial difficulties affecting one of the portfolio companies should be limited and not jeopardise its proper functioning, since the Fund could continue to benefit from the capital and financial strength of the other portfolio companies.

b) The Fund's target IRR is sufficiently high to ensure adequate levels of liquidity for the Fund.

   If this requirement is verified, this means, in our opinion, that the risk of affecting the solvency of the Fund due to a poor performance of any one - taken individually - of its investments is reduced; this, as the revenues generated by the other portfolio companies would be more likely to compensate for the investment with a negative performance.

c) There is de-correlation of the portfolio company's business risk from the Fund's inherent business risk, in the sense that the Fund acts, according to proper logic, as a pure investment vehicle implementing adequate diversification (sectoral and/or geographical) of its investments in the interest of the shareholders

If this requirement is verified, it means, in our opinion, that there is no risk of having a high degree of correlation between the various investments, as is usually the case in an industrial group that would have an interest in exploiting synergies with its subsidiaries; therefore, in the absence of correlation, the possible difficulties of a portfolio company would not affect the solidity of the Fund.