

EBA, EIOPA and ESMA's Response to the European Commission's Call for Advice on the Fundamental Review of the Financial Conglomerates Directive

London, Frankfurt, Paris, 2 October 2012

(JC/2012/88)

Contents

1. Executive Summary	3
2. Background and rationale	7
3. Advice	11
3.1 The scope of the Financial Conglomerates Directive (FICOD) and its perimeter of supervision.....	11
3.2 Governance requirements and the ultimate responsible entity.....	23
3.3 Strengthening sanctions and enforcement under FICOD	40
4. Annexes.....	50
Annex A – Summary of the answers to an ESA questionnaire	50
Annex B – Draft Impact Assessment.....	60
Annex C – Definitions.....	70
Annex D – Consolidation of SPEs/SPVs	73
Annex E – Structures of a financial conglomerate.....	75
Annex F – Current EU requirements and the new Joint Forum Principles	78
Annex G – Group requirements	83

1. Executive Summary

1. The Joint Committee of the European Supervisory Authorities' Sub-Committee on Financial Conglomerates (JCFC) received a **Call for Advice from the European Commission in April 2011** to look at the (A) scope of application, especially the inclusion of non-regulated entities (B) internal governance requirements and sanctions, and (C) supervisory empowerment of Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (FICOD¹). This advice shall contribute to the European Commission's fundamental review of the FICOD, following the short technical review, resulting in Directive 2011/89/EU (hereafter FICOD¹²).
2. The Joint Committee wishes to highlight that the sectoral legislations are still under negotiation at the time of delivery of this report. Therefore the Commission would need to pay due attention and take into consideration the final versions of the sectoral texts once stabilised.
3. As a result of its analysis, the EBA, EIOPA and ESMA, hereinafter the ESAs, propose the following answers to the questions risen by the Commission in its fourth Call for Advice (hereinafter CfA):

Question 1 CfA³: What should be the perimeter of supervision, when a financial conglomerate is supervised on a group wide basis?

4. **Recommendation 1:** The **Perimeter of supervision should be enlarged** to ensure a more thorough group wide supervision and avoid possible regulatory arbitrage, by enhancing the groups of entities that can be included in the identification of a financial conglomerate. Accordingly the ESAs suggest to allow for a more consistent and broader identification of financial conglomerates to modify the definition of "financial sector" [according to Article 2 (8) FICOD] and/or the definition of "regulated entities" [according to Article 2 (4) FICOD]. Therefore, in concrete terms, the definition of financial sector [Article 2 (8) FICOD] should be enlarged to include **insurance ancillary services undertakings** for consistency reasons with sectoral legislation. Moreover, with regard to **SPEs and SPVs**, we recommend that in principle all special purpose vehicles/entities must fall under the perimeter of supervision of a financial conglomerate, because these may not always be

¹ See [Directive 2002/87/EC](#)

² The [Directive 2011/89/EU](#), amending Directives 98/78/EC ("IGD"), 2002/87/EC [FICOD], 2006/48/EC "CRD") and 2009/138/EC ("Solvency II") as regards the supplementary supervision of financial entities in a financial conglomerate, was published in the Official Journal on 8 December 2011 enabling supervisors to simultaneously apply banking consolidated supervision, insurance group supervision and supplementary supervision at the level of the same parent entity, in case that parent is a holding company. This is the result of a lesson learnt during the crisis, where supervisors were faced with a lack of powers especially at the level where crucial group-wide decisions should have been taken for these large complex financial institutions.

³ See Part 1 of the advice below.

captured by sectoral legislation or accounting rules. The inclusion of these vehicles/ entities should guarantee that the risks arising from entities within a group are appropriately captured, regardless of their nature (e. g. shadow banking).

5. The ESAs have assessed whether Institutions for occupational retirement provision (IORPs) should be included as part of a financial conglomerate and are mindful of the national specificities of IORPs. Views were mixed, especially as the national specificities are very diverse.

The ESAs recommend maintaining the status quo for the time being i.e. the FICOD does not include IORPs within group wide supervision at cross-sectoral level. The ESAs have noted that the IORP directive is currently reviewed and a quantitative impact assessment is carried out in order to determine the capital requirements attached to IORP activities. The work is expected to be undertaken by June 2013. The ESAs recommend therefore to the Commission to set a review clause at that time and to mandate the ESAs to work again on this issue.

6. **Recommendation 2: Mixed financial holding companies (MFHCs), even if unregulated, should be made subject to supplementary supervision** or any type of requirements that are proposed below. Accordingly, MFHCs should be included together with regulated entities as the legal addressee of supplementary supervision.
7. **Recommendation 3:** Companies undertaking solely industrial activities (with no financial services activity at all), such as industrial conglomerates, should not be subject to direct financial supervision as the supervisory focus might be diverted from financial undertakings. **Mixed activity holding companies (MAHCs) and mixed activity insurance holding companies (MAIHCs)** should not become direct addressees of FICOD, but the supervisor should have the ability to access relevant information from such MAHC and MAIHC within its **supervisory tool kit**. The following supervisory tools are not mutually exclusive
8. Supervisors should be empowered to choose from the set of tools where appropriate:

Tool 1 – To require the creation of an **intermediate financial holding** which is responsible for all the entities (or at least, all the regulated entities) carrying out financial activities subject to supplementary supervision and which will be the “addressee” for supervision.

Tool 2 – To designate one single “**point of entry**” at the top of the **unregulated entities** in place of a formal ‘common chapeau’ of the financial entities in the group. This point of entry is not a legal person, but a simple reference for the supervisors (e.g. a specific team or division or a member of the Board of the parent entity).

Tool 3 – To designate a specified **regulated entity as point of entry** which does not necessarily need to be the top entity of the entire financial conglomerate. This option has merit if the enforcement requirements and sanctioning measures addressed to the top entity cannot be adequately enforced by the supervisors.

Question 2 CfA⁴: Given your experience and expertise, which legal entity in a conglomerate should be responsible and qualify for compliance with group wide requirements, i.e. which legal entity should be the responsible parent entity?

9. **Recommendation 4:** The European Commission should identify and define **an ultimate responsible entity** for the financial conglomerate according to the following **minimum criteria**: control, the dominant entity from the market’s perspective (market listed entity) and the ability to fulfil specific duties towards its subsidiaries and its supervisor.

Question 3 CfA⁵: Given your supervisory experience and expertise, which requirements should be imposed on this qualified parent entity in the context of group wide supervision?

10. **Recommendation 5:** This **ultimate responsible entity should be responsible for compliance** with group wide requirements. The European Commission should explicitly require the ultimate responsible entity to have a **coordinating and directing role over the other entities of the conglomerate**. Moreover, some existing requirements for regulated entities and requirements that can be derived from the ESAs’ guidelines on Internal Controls should also be applicable for the top parent entity, whether the entity is a Holding Company or a Financial Holding Company (FHC), Insurance Holding Company (IHC) or a MFHC.

⁴ See Part 2 of the advice below.

⁵ See Part 2 of the advice below.

Question 4 CfA⁶: Given your supervisory experience and expertise, which incentives (special benefits or sanctions) would make the enforcement of the group wide requirements more credible?

11. **Recommendation 6**: In order to ensure that the group wide requirements are enforceable, the European Commission should **develop an enforcement regime towards the ultimate responsible entity** and its subsidiaries. This would imply a **dual approach** with enforcement **powers towards the top entity** for group-wide risks **and towards the individual entities** for their respective responsibilities. Corrective measures should be directed towards the entity that is responsible for the respective breach.
12. **Recommendation 7**: In any case, the supervisor should have a minimum set of measures, consisting of informative and investigative measures, at hand (see Recommendation 3). Supervisors should be able to **administer sanction measures addressed at the MAHC or MAIHC**, where this entity does not to provide the requested information. Moreover, when (under Tool 1, Recommendation 3) an intermediate financial holding company has been established, supervisors should be able to administer sanction measures at this **intermediate financial holding company**.

Question 5 CfA⁷: When reflecting upon this advice, would supervisors in Europe need other or additional empowerment in their jurisdictions?

13. **Recommendation 8**: Whilst the FICOD provides the ESAs and the supervisors with a large supervisory tool kit, supervisor's actual use of this tool kit should be enhanced. Further a minimum set of enforcement measures that national supervisors should have at their disposal towards the group (Article 16 FICOD), should be achieved by the **ESAs developing guidelines** or by being asked to develop **binding technical standards** for a **common reporting scheme on risk concentrations and intra group transactions**, (including the possible development of guidelines for quantitative limits under Article 7 (3) and 8 (3) FICOD). This also implies creating a minimum set of sanctioning measures that should be applied towards the group in case of a breach of group-wide requirements. In addition, the European Commission should take into account sectoral differences that may arise between CRD IV and Solvency II.

⁶ See Part 3 of the advice below.

⁷ See Part 3 below.

2. Background and rationale

2.1 Lessons learnt from the financial crisis

14. The Joint Committee⁸ of the European Supervisory Authorities' Sub-Committee on Financial Conglomerates (JCFC) received a Call for Advice from the European Commission (EC) in April 2011 to assist the European Commission in its fundamental review of the **Directive 2002/87/EC** on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (hereafter FICOD⁹). The fundamental review follows the technical review, resulting in the **Directive 2011/89/EU** amending Directives 98/78/EC, 2002/87/EC [FICOD], 2006/48/EC and 2009/138/EC as regards the supplementary supervision of financial entities in a financial conglomerate, published in the Official Journal on 8 December 2011 (hereafter FICOD1)¹⁰. FICOD1 enables supervisors to simultaneously apply banking consolidated supervision, insurance group supervision and supplementary supervision at the level of the same parent entity, in case that the parent is a holding company. This is the result of a lesson learnt during the crisis, where supervisors were faced with a lack of powers especially at the level where crucial group-wide decisions should have been taken for these large complex financial institutions.
15. The European Commission has asked the JCFC to conduct '*an assessment of supervisory practices and experiences, in the context of international developments and recently available legislation, in the areas of (A) scope of application, especially the inclusion of non-regulated entities (B) internal governance requirements and sanctions, in particular with respect to the obligations of the parent entity, and (C) supervisory empowerment, in particular the necessary legislative provisions in case the parent entity is a (non-regulated) holding company*'.
16. The request for this review has to be put in the **context of the current financial crisis**.

⁸ The Joint Committee is a forum for cooperation that was established on 1 January 2011, with the goal of strengthening cooperation between the European Banking Authority (EBA), European Securities and Markets Authority (ESMA) and European Insurance and Occupational Pensions Authority (EIOPA), collectively known as the three European Supervisory Authorities (ESAs). Through the Joint Committee, the three ESAs cooperate regularly and closely and ensure consistency in their practices. In particular, the Joint Committee works in the areas of supervision of financial conglomerates, accounting and auditing, micro-prudential analyses of cross-sectoral developments, risks and vulnerabilities for financial stability, retail investment products and measures combating money laundering.

⁹ See <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:035:0001:0027:EN:PDF>
<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:326:0113:01:EN:HTML>

17. First, among the lessons learned, there is an emerging consensus that the **financial activities performed by a group should be appropriately supervised, regardless of whether those activities are performed by regulated or non-regulated entities**. As evidenced from the financial crisis, risks undertaken by non-regulated entities often impact adversely the overall group to which they belonged. The different treatment of regulated and non-regulated entities, sometimes designed to take advantage of differences in taxation, in terms of capital requirements calculations, may have been an incentive to perform financial activities through such non-regulated entities, thus creating complex and opaque group structures which hinder the adequate identification of risks, not only for the supervisors, but also for the groups themselves.
18. Second, the crisis has evidenced the need to extend the supervisory powers to the entities performing financial activities that are relevant, in terms of risk, to the whole group. Accordingly it is necessary to identify which entities should be included within the perimeter of supervision, so that supervisors have the powers to assess the risks within a group.
19. In this regard, the treatment of *unregulated* parent holding companies controlling *regulated* entities needs to be revised. Currently, unregulated parent holding companies are often under no obligation to provide information to supervisors. Since no requirements apply directly to those unregulated entities, some supervisors apply an indirect approach (via the regulated entities). Thus, the question arises as to whether a more direct approach is desirable.
20. Finally, where requirements are directed towards unregulated parent holding companies, those requirements should be enforceable.

2.2 International consistency

21. The Joint Forum has consulted on its proposals for revising its Principles for the Supervision of Financial Conglomerates ("**Joint Forum Principles**¹¹"). The ESAs, through the JCFC, are committed to follow closely the outcome of the work of the Joint Forum and assess its application to the EU single market.

¹¹ See Joint Forum consultation launched on 17 December 2011 which closed on 16 March 2012: <http://www.bis.org/publ/joint27.htm>.

2.3 Legal texts

22. While preparing this advice, the ESAs were mindful of the objective of FICOD, which is to serve as a supplementary Directive to address the loopholes in sectoral legislation and address additional prudential risks in a financial group with cross sectoral financial activities. Since at this juncture, the sectoral legislation (Solvency II¹² and CRD IV¹³) are still under negotiation, this draft advice could only be prepared on the basis of the sectoral texts as they stood¹⁴.
23. The ESAs acknowledge that there is no certainty about the final versions of Solvency II and CRD IV/CRR at the time of drafting this report. Further, the ESAs are aware that Solvency II also establishes some group wide requirements. However, at this juncture, the ESAs wish to answer the very precise questions that were raised by the Commission within its Call for Advice in April 2011. The ESAs do not wish to exceed this very clear mandate set-up by the Commission within this report. Nevertheless, the ESAs might publish a paper on a further, more fundamental review of FICOD in the future.

2.4 Relation to company law

24. Throughout this advice (especially part 2) topics that are also the subject of company law for corporate groups will be touched upon. Company law for corporate groups is not harmonized within the EU and this advice is not meant to change this point of departure. However, prudential supervisors are authorised and obliged to exercise consolidated/supplementary supervision and can therefore intervene in intragroup relations. The exercise of consolidated/supplementary supervision is of public interest to the safety and soundness of the financial sector and may under certain circumstances surpass the purely private law relationships between companies.

¹² Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance, OJ 335, p. 1; <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:335:0001:0155:EN:PDF> .

¹³ Proposal for a Directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate, COM(2011) 435 final - 2011/0203 (COD); <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0453:FIN:EN:PDF>.

¹⁴ See also 'Omnibus II' Directive: Proposal for a Directive of the European Parliament and of the council amending Directives 2003/71/EC and 2009/138/EC in respect of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority, COM/2011/0008 final - 2011/0006 (COD); <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0008:FIN:EN:PDF>.

25. This does not imply that prudential supervisors can act against company law principles, such as the fundamental principle of legal personality of each entity within a group and the reverse side of this principle, namely that the group as such cannot be addressed by the supervisors. On the contrary, this advice takes into account a general trend in company law throughout the EU. From different countries, case law, corporate governance codes (at times even with a binding character if they are endorsed through legal acts) and sometimes company laws themselves signal that they are more and more also means of organizing corporate groups on a day-to-day basis. Wherever the text below might have implications on company law, these principles have been taken into account.
26. This advice gives at different instances a more concrete content to what it means for a group to organize itself in a prudentially sound way. If supervisors are not confident that the group's internal organisation is sufficiently supportive for the consolidated/supplementary supervision, they shall be able to take measures or sanctions against the different group entities: each respective supervisor involved in the group supervision for that entity over which it has authority and with respect to that entity's role and duties within the functioning of the group. "Group decisions" that have implications for a particular regulated entity within the group must make it through to the latter's own governance mechanisms at legal entity level (by accepting them, by rejecting them etc.), so that it can be held responsible against them. Supervisors cannot however enforce that one entity instructs another group entity in such or such way, nor can they enforce that the latter follows up these instructions. It is also not possible that a group entity is held responsible for the infringements made by another legal entity. (See part 2 and 3.)

2.5 Terminology

27. This paper refers to the terminology used in the sectoral Directives (see also **Annex C**). In cases where a European definition was still missing, the ESAs have defined specific terms for the purpose of this paper.

3. Advice

Part 1

3.1 The scope of the Financial Conglomerates Directive (FICOD) and its perimeter of supervision

3.1.1 Rationale and Background

28. Among the lessons learned from the **financial crisis**, a wide consensus emerged on the need to extend the supervisory powers to the entities performing financial activities that are relevant to the whole group. For this purpose, the first step is the identification of the entities to which supervisory powers have to be extended; in other words, a **perimeter of supervision needs to be established in order to control the risk distributions inside a group more efficiently**.
29. The **Joint Forum's Review of the Differentiated Nature and Scope of Financial Regulation**¹⁵ highlighted in its fourth recommendation the need for policymakers to ensure that all financial groups are subject to supervision and regulation that captures the full spectrum of their activities and risks. In the same recommendation, the Joint Forum acknowledges that the risks assumed by unregulated companies within a group may significantly affect the whole group. As a consequence, it also stresses the need to apply group wide supervision to financial groups.
30. Since many of the European financial conglomerates are operating on a world wide scale, any European policy initiative has to be aligned with global agreements, to ensure internationally consistent regulation and supervision. In this context, the latest draft of the Joint Forum Principles introduced a definition of financial conglomerates that is consequently relevant for the revision undertaken in Europe. According to the proposed **Joint Forum definition**¹⁶, a financial conglomerate is "*any group of companies under common control or dominant influence, including any financial holding company, which conducts material financial activities in at least two of the regulated banking, securities or insurance sectors*".¹⁷ The scope of application further details that "*Jurisdictions should consider the application of the*

¹⁵ <http://www.bis.org/publ/joint24.htm>

¹⁶ It should be noted that in the European framework (FICOD), the banking and investment (securities) sectors are considered together, so that the very last sentence should be understood as referred to activities in both of the regulated sectors (insurance and banking-investment services).

¹⁷ In the Commission's Call for Advice that in relation to the definition of a Financial Conglomerate, the Commission stated that it intends to follow the Joint Forum in this respect

Principles to other financial groups which conduct activities in one of these regulated sectors while also conducting material activities in any other financial sector, where these financial activities are not subject to comprehensive group-wide supervision under the sectoral frameworks”.

31. The Joint Forum Principles focus also on the need to ensuring effective supervision of risks arising from unregulated financial activities and entities. In deciding which unregulated entities may be relevant, the Joint Forum recommends that consideration should be given, at a minimum to operating and non-operating holding companies, unregulated parent companies, subsidiaries and special purpose entities (SPEs).

3.1.2 Relevant provisions of the Financial Conglomerates Directive

32. **Two different regulatory perspectives** can be considered for assessing the appropriateness of the perimeter of financial activities under FICOD. One could enlarge the scope of application of the FICOD by widening the **range of entities** that can be considered as legal addresses (the ultimate responsible entities to which enforcement actions can be addressed). Alternatively, there is a possibility to widen the perimeter of entities and/or activities considered in the **definition of financial sector**.
33. **The scope of application** is currently defined in **Article 5 (1) FICOD**, which establishes that “*Member States shall provide for the supplementary supervision of the regulated entities referred to in Article 1*”. Article 1 FICOD defines the objective of the Directive listing the **regulated entities** to which supplementary supervision applies. This list is further summarised in **Article 2 (4) FICOD**, which defines a regulated entity as “***a credit institution, an insurance undertaking, a reinsurance undertaking¹⁸, an investment firm, an asset management company or an alternative investment fund manager***”. Non-regulated entities are currently not addressed by the Directive.
34. **The perimeter of the financial sector** is defined in **Article 2 (8) FICOD** as the aggregation of the banking, insurance and investment services sectors. Further, the definition of “financial sector” and the sub-sectors are

¹⁸ The definition of “reinsurance undertakings” already includes special purpose vehicles (SPVs) within the meaning of Article 13 (26) of Directive 2009/138/EC on the taking up and pursuit of the business of Insurance and Reinsurance (Solvency II).

relevant for the process of identifying financial conglomerates, which are described in Article 3 of the FICOD.

35. According to **Article 3 (1) FICOD**, the financial activities of a group, are considered to be significant if they are over 40% of the total activities of the group (in terms of balance sheet total). Moreover, this threshold is only relevant for the identification of financial conglomerates, whose parent entity is a non-regulated entity. Whenever a regulated entity is the top entity of the group, the financial character is assumed, regardless of the relative size of the financial sector to the non financial sector. As a consequence, the enlargement of the “financial sector” is not relevant for those financial conglomerates with a regulated entity at the top.

3.1.3 Identification of problems and regulatory gaps

36. The ESAs directed a stock take to the National Supervisory Authorities (NSAs) in order to identify the issues related to the scope of application and the definition of the financial sector where the FICOD may not be achieving its objectives (**see Annex A**). The questionnaire responses highlighted a high degree of heterogeneity, often due to the mixed concepts regarding the scope of application and the definition of the financial sector for identification purposes.

3.1.4 Policy options on widening the scope

37. To tackle the problem and the regulatory gap identified, **all financial activities** that pose a relevant risk to the group should be taken into account for the purpose of an effective supervision, **irrespective of whether those activities are conducted through regulated or unregulated entities**. Accordingly, all these relevant financial activities should be considered when identifying the existence of a financial conglomerate.
38. In order to limit regulatory arbitrage and to avoid that groups circumvent the application of the FICOD, the range of financial activities that are used to define the financial sector and to identify a conglomerate should be enlarged. In addition to widening the definition of financial sector, it is also proposed to

enlarge the range of entities that can be considered as legal addresses of the FICOD.

3.1.4.1 Institutions for occupational retirement provisions within the meaning of Directive 2003/41/EC (IORP-Directive)

39. The consideration of the risks posed by IORPs within the meaning of the IORP-Directive¹⁹ has been identified as a relevant issue. However, given the diversity of IORPs among Member States, it is difficult to analyse the risks that they may pose to the financial system and to the groups in a harmonised way. Whilst IORPs have legal personality in some Member States, in other Member States they do not. Further, for many Member States, the pension arrangements are managed by entities duly authorised to this activity.²⁰
40. The allocation of risks to the group is more relevant than the existence of legal personality. Depending on the different arrangements, IORP's risks can be taken by the IORP itself or by its members or beneficiaries of the pension arrangement or by the group to which the IORP belongs. Therefore a group that has an IORP in its structure must identify the risks the IORP can pose to the group.
41. As regards pension entities outside the scope of the IORP-Directive, each Member State should decide on its treatment on a national basis. This will provide the necessary flexibility to empower supervisors to take direct and proportionate action after taking into account the particular nature of their entities.
42. After a public consultation on the possible inclusion of IORPs into the scope of FICOD the ESAs recommend to maintain the **status quo** for the time being. IORPs continue to be supervised according to the IORP Directive and the FICOD Directive does not include IORPs within supplementary supervision at cross-sectoral level for the time being. However it seems questionable whether this option might solve the problem of possible regulatory arbitrage since relevant group risks could potentially remain outside the scope of supplementary supervision, maintaining the incentive

¹⁹ Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision, *OJ 2003 L 235*, See <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32003L0041:EN:HTML>.

²⁰ See also Art. 2 IORP Directive.

for entities to create opaque structures. The ESAs therefore call upon the Commission to re-examine this scope issue in the light of the outcome of the quantitative Impact Assessment for IORPs currently undertaken by EIOPA in the on-going IORP Directive review process.

3.1.4.2 Ancillary insurance services undertakings

43. Ancillary insurance services undertakings, as defined in Article 1bis (23) of the draft implementing measures of Solvency II, should be included in insurance sector according to the definition of financial sector in Article 2 (8) FICOD. This inclusion would guarantee consistency with the banking sector, where ancillary banking services undertakings are already included.

3.1.4.3 SPVs/SPEs

44. One of the lessons learnt from the recent crisis has been the need to better understand and take into account risks posed by special purpose entities/vehicles (SPEs/SPVs) to financial groups. Therefore, it is proposed to **include SPEs/SPVs** in order to capture all relevant financial activities of a financial conglomerate. This would mean including Securitisation SPE (SSPE)²¹, as defined in Article 4 (44) CRD IV Proposal²² and Article 4 (45) CRR IV Proposal²³, as well as other SPVs²⁴ that are not currently captured by Article 13 (26) Solvency II **in the definition of financial sector (Article 2 (8) FICOD)**. Such entities should be included in either the banking or insurance sector, depending on which group they belong to, or to the smaller sector in case the entity does not belong exclusively to one sector. The

²¹ **Securitisation special purpose entity (SSPE)** means a corporation trust or other entity, other than a credit institution, organised for carrying on a securitisation or securitisations, the activities of which are limited to those appropriate to accomplishing that objective, the structure of which is intended to isolate the obligations of the SSPE from those of the originator credit institution, and the holders of the beneficial interests in which have the right to pledge or exchange those interests without restriction.

²² Proposal for a Directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate, 20.7.2011, COM (2011) 453 final; 2011/0203 (COD).

²³ Proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms PART I-III, 20.7.2011; COM (2011) 452 final; 2011/0202 (COD).

²⁴ **Special purpose vehicle (SPV)** means any undertaking, whether incorporated or not, other than existing insurance or reinsurance undertaking, which assumes risks from insurance or reinsurance undertakings and which fully funds its exposure to such risks through the proceeds of a debt issuance or any other financing mechanism where the repayment rights of the providers of such debt or financing mechanism are subordinated to the reinsurance obligations of such an undertaking.

additional question on how to determine when the consolidation of an SPE/SPV is appropriate is addressed in **Annex D**.

45. The Joint Forum's consultation on the Principles for the Supervision of Financial Conglomerates states that there should be a process for determining whether an SPE is fully or proportionally consolidated. An assessment of risk transfer between financial conglomerates obligations towards the SPEs should form part of the determination to consolidate a SPE. For example, a high degree of linkage in terms of services or obligations may constitute a basis for consolidation. The absence of an ownership interest should not prevent a SPE from being consolidated.
46. Other factors should be taken into account such as whether or not contagion risk exists between the regulated entity and the SPE. Group risk usually exists where there is a relationship of control, economic interconnectedness or contagion.
47. Given that the usual criteria to trigger consolidation do not always exist in SPEs/SPVs, there is a need to address **how to capture these entities**. Under the sectoral consolidated supervision frameworks, subsidiaries, participations and other entities related to the firm by virtue of Article 12 (1) and Article 134 (BCD only) relationships are included within the scope of consolidation. However, these relationships are often difficult to identify in the context of SPEs. Thus, a consistent treatment of SPEs within a group is often missing.
48. This can result in a regulatory group which is not aligned with the scope of the accounting group and/or which may not be aligned with the true nature of the risks that the group is exposed to. Where appropriate, better alignment could avoid regulatory arbitrage. It should be noted however that a regulatory group does not always have to be aligned with an accounting group.
49. With regard to the **banking sector**, in most countries, SSPEs are not regulated but may be supervised under the consolidated supervision of the bank to which they belong. According to most of the responses to the questionnaire (see Annex A), also other types of SPEs, though not defined in the banking Directives, should be included for the reasons mentioned above.
50. With regard to the **insurance sector**, SPVs, as defined in Article 13 (26) Solvency II, are regulated entities in Article 2 (4) FICOD and should be included in the definition of financial sector in Article 2 (8) FICOD. According

to the sectoral rules, these types of SPVs linked to re-insurance are not included in the group solvency calculation but they are included for other aspects of group supervision, such as governance and reporting requirements, because they are fully funded and they are not required to have a capital requirement at solo level. These types of SPVs should be treated on conglomerate level in the same way they are treated on sectoral level (Solvency II). The other types of SPVs, different from the SPVs defined in Article 13 (26) Solvency II, should be included in the capital requirement calculation at the level of the conglomerate as well (see Annex A). This means that, following the draft implementing measures Solvency II, they should be fully consolidated.

3.1.5 Consequences of widening the scope in terms of thresholds tests

51. **No conclusion** can yet be drawn on the effect which the inclusion of the entities mentioned above might have on **threshold calculations**, for a number of issues. First, there is not yet any quantitative assessment of the impact of enlarging the definition of the financial sector. Second, if thresholds were modified due to the inclusion of SPEs in the definition of financial sector, and the wording of Article 3 (5) FICOD would remain, allowing (not imposing) the use of alternative parameters (as total assets under management), the result could be a complex combination. The use of these alternative parameters in Article 3 (5) FICOD is to be decided by each supervisor and in exceptional circumstances. Finally, the inclusion of new entities in the thresholds calculations **might not necessarily result in the identification of more conglomerates** and its subsequent supplementary supervision. It might be the case that the new activities to add to the financial sector definition could belong to the biggest sector (banking or insurance). In this case, this would reduce the possibility to fulfil the threshold in Article 3 (2) FICOD (relative size of one sector compared to the other) and consequently might avoid the identification of certain financial conglomerates.

3.1.6 Waivers

52. Under the original FICOD text, the waiver was available where the group's smallest financial sector was less than 10% but exceeds EUR 6 billion. FICOD1 extends waiving capacities to the "small financial conglomerates",

i.e. financial conglomerates where the smallest financial sector is in excess of 10% but less than EUR 6 billion, in order to avoid unnecessary burden on very small groups which do not pose relevant risks.

53. In order to ensure the risk-based application of the waivers, Article 3 (8) FICOD1 introduces an obligation of the ESAs to issue, through the Joint Committee of the ESAs, **guidelines** aimed at the convergence of supervisory practices with regard to the application of the waivers. This task has not yet been developed by the Joint Committee.
54. Given that the fundamental review is tasked with reviewing the waivers included in Article 3 FICOD²⁵, it could be appropriate to veer away from FICOD1 and reassess the validity of such waivers against the objectives of the FICOD. Accordingly consideration should be given to the appropriateness of waivers going forward, especially in view of the other changes to the FICOD that are being suggested. However, taking into account that the result of the guidelines to ensure a risk-based application of waivers is still pending, and that the effects on the threshold of enlarging the definition of the financial sector following this proposal need a careful assessment of its quantitative impact, it would be premature at this stage to issue any proposal on the use of waivers.

3.1.7 The treatment of holding companies according to FICOD

55. The Draft Joint Forum Principles mention operating and non-operating holdings. For the purpose of this paper and within the jurisdiction in the EU, an **operating holding company** is a supervised and regulated entity (on solo-level) and a non-operating holding is an entity which holds stakes (as parent entity or as holder of a participation) of a regulated and supervised entity; the **non-operating holding** is not subject to supervision and regulation on solo level. Eventually, it will only be supervised on a group-wide basis. With respect to this paper a non-operating holding can be a Financial Holding Company (FHC), an Insurance Holding Company (IHC), a Mixed Activity Holding Company (MAHC), a Mixed Activity Insurance Holding Company (MAIHC) or a Mixed Financial Holding Company (MFHC).²⁶

²⁵ See Recital 12 in FICOD1.

²⁶ Please find further possible structures of financial conglomerates under Annex E.

56. A **Mixed Activity Holding Company (MAHC)** is defined in Article 4 (71) CRR IV Proposal as *a parent undertaking whose subsidiaries include at least one credit institution or investment firm*. There is no clear threshold defined (like the threshold for financial conglomerates) that qualifies a Mixed Activity Holding Company as a Financial Holding Company, making it subject to (group wide) supervision according to CRD. According to Article 4 (63) CRR IV Proposal a **Financial Holding Company** is *an undertaking, other than a credit institution, with the principal activity to acquire holdings or to pursue activities of mutual recognition and whose subsidiaries belong "exclusively or mainly" to the banking/investment sector*.
57. A **Mixed Activity Insurance Holding Company (MAIHC)**, is defined in Article 212 (1) lit. g Solvency II as *a parent undertaking that holds at least one supervised and regulated subsidiary of the insurance sector*. There is no clear threshold defined (like the thresholds for financial conglomerates) that qualifies a holding company as an Insurance Holding Company and that might make it subject to (group wide) supervision according to Solvency II. According to Article 212 (1) lit. f Solvency II, an **Insurance Holding Company** is *a parent undertaking whose main business is to acquire and hold participations in subsidiary undertakings that belong "exclusively or mainly" to the insurance sector*.
58. Consequently, for both types of holding companies there is no **precise definition**. Thus, supervisors may interpret these companies in a different way which may lead to inconsistency and hinder the achievement of a level-playing-field within the EU. When identifying mixed holding companies the supervisor should take into account, for example, the book-value of its participation(s), balance sheet sum, income structure or/and capital requirements (of the participation). This idea follows the concept of identifying financial conglomerates and may lead to a harmonised approach.
59. It is noted that the CRD IV-Proposal provides supervisors with the task to solve this issue, under its Articles 116 to 118, which relate to the exchange of information for MAHCs, and under Article 65, referring to possible sanctions against MAHCs. However, those MAHCs are not subject to supervision, neither on a solo nor on a group wide level. This may lead to regulatory arbitrage and the possibility of double gearing.
60. In respect of MAHC and MAIHC, it is viewed that they should not be included in the scope of FICOD because such entities are not regulated, and as such it might not be feasible to impose FICOD enforcement actions on them. Since

MAIHC and MAHC are by definition “industrial” – i.e. not mainly active in the insurance/banking/investment sector – they cannot be treated exactly in the same way as if they were insurance/banking entities, insurance/banking holding companies or Mixed Financial Holding Companies. But their **inclusion could be considered for very limited purposes**, namely for providing the relevant supervisory information and for internal governance requirements.

3.1.7.1 Policy options on Mixed Financial Holding Companies (MFHCs)

61. **MFHCs, even if unregulated, should be made subject to supplementary supervision** or to any type of requirements that are proposed below (see paragraph 63). Therefore, MFHCs should be listed besides regulated entities as the legal addressee of supplementary supervision in Article 5 FICOD.
62. This inclusion could alleviate the regulatory gaps identified in the preceding paragraphs. At the same time, some policy options which are described below with regard to MAHC and MAIHC should also be applied on MFHC. Therefore, in the following section regarding MAHC and MAIHC, whenever it is considered appropriate, a specific consideration may be formulated with regard to the application of policy options to MFHC as well.

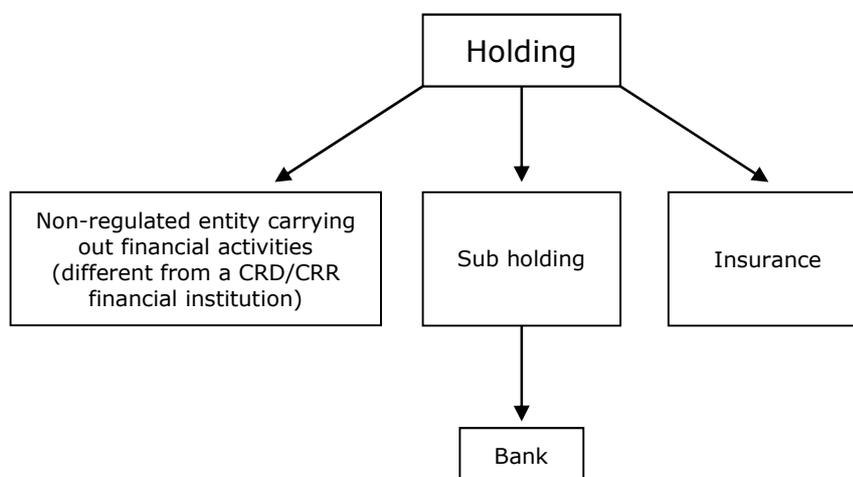
3.1.7.2 Policy options on MAHC and MAIHC

63. This section covers those groups that have a predominant industrial part at the level of the MAHC/MAIHC.²⁷ Therefore, at the top level, a financial conglomerate cannot be identified. However, it could be possible to identify a subgroup which is a financial conglomerate according to the FICOD. If this is not the case, FICOD will not apply as there is no financial conglomerate at all. The possibility to identify a **financial conglomerate at a subgroup level** below the MAHC/MAIHC may require the identification of a parent holding from the control point of view (as ultimate responsible entity of the group). For details, please refer also to **Annex E**.
64. MAHC and MAIHC should be excluded from both, the scope of application and the definition of the financial sector. However, MAHC and MAIHC may be

²⁷ Please find a detailed overview on existing complex group structures in **Annex E**.

subject to particular requirements, such as **ad-hoc reporting obligation** to the supervisor (as considered appropriate below paragraph 93, 99 and 143).

65. The following paragraphs will describe some possible **supervisory tools** towards MAHCs and MAIHCs. It must be noted that they are **not necessarily mutually exclusive**. The **advantages and disadvantages** of these tools are described in detail in **Annex B**, part 1:
66. **Tool 1** – Supervisors could be empowered to require the creation of an **intermediate financial holding** which holds all the entities carrying out financial activities subject to supplementary supervision (or, at least, all the regulated entities). Due to specificities of the conglomerate or the jurisdiction, this power should be granted by supervisory decision on a case by case basis. In addition, some criteria should be determined in order to facilitate supervisory consistency as to how and when to exercise the power. Firstly, this power could be exercised only when:
- there is an industrial component in the group; or
 - there is no industrial component in the group, but there are unregulated entities which carry out financial activities, which are not directly linked to the regulated entities or, which do not fall in the consolidation perimeter at sectoral level.



67. **Tool 2** requires the designation of a single “***point of entry***” at the **(unregulated or regulated) top entity** of the entire industrial group, in place of a formal ‘common chapeau’ of the financial entities within the group. This point of entry is the single reference for the supervisors. This reference may be identified in a specific team or division or a member of the Board in the (unregulated or regulated) top entity. In that case the supervisor identifies the point of entry as the responsible one for all supervisory actions (e.g. setting up controlling and risk management for the whole group and providing all the relevant information).
68. **Tool 3** consists in designating a ***regulated entity as a point of entry***, such that the entity responsible for performing the specific duties towards the supervisors is the legal addressee of supplementary supervision, though it might not be at the top of the financial conglomerate. In some Member States, this or a similar tool might already be applicable. However, the particularity of this proposed tool is that the designated entity would be responsible for the entire group (e.g. if the leading entity is a bank, it would be made responsible also for its insurance subsidiaries). This option enables enforcement requirements and sanctioning measures to be set at the ultimate responsible entity within the group.

Part 2

3.2 Governance requirements and the ultimate responsible entity

3.2.1 Reasons to identify a responsible entity in a financial conglomerate

69. Recent developments in the supervisory framework for financial conglomerates both at European level (with the adoption of FICOD1) and at G20 cross-sectoral level ("Proposed Joint Forum Principles") provide the idea for the identification of an ultimate responsible entity in a financial conglomerate, which could ensure an efficient supervision of such groups with an all-encompassing assessment of the group's risks.
70. Both developments consider it would be appropriate to assign direct responsibilities to certain top entities in a financial conglomerate, such as for compliance with prudential requirements than it is currently the case in EU and G20 members' legislation. Both developments introduce also the idea that group governance is crucial for enhancing supervision on these ultimate responsible entities.

3.2.1.1 Legal changes according to FICOD 1

71. FICOD1 revised technical aspects of FICOD and provided a series of identical amendments to sectoral Directives aimed at addressing the issue of "top level supervision" (i.e. indirect supervision of non-regulated top entities).
72. In particular, due to mutually exclusive definitions of MFHC, FHC and IHC²⁸, in certain instances, the original text of the FICOD caused the scope of the sectoral group supervision to fall away, depending on the structure of the financial conglomerate.
73. To avoid this undesirable consequence, every time
- (i) the words "insurance holding company" appear in IGD or Solvency II Directive, or
 - (ii) the words "financial holding company" appear in the CRD

²⁸ See paragraph 5.1 of the Explanatory Memorandum to FICOD1.

FICOD 1 **added** the words "**or mixed financial holding company**". Thereby FICOD 1 implicitly reached an important step further with reference to top level supervision: whatever group supervisory regime is applicable, the entity which drives the strategies of the group should be included in the supervision.

74. In the context of a further enhancement of supplementary supervision (i.e. the envisaged fundamental review of the FICOD, hereafter "FICOD 2") this facilitates that **the steering entity should not only be included in the supervision but should also be held responsible for the role it plays within the financial conglomerate and within the sectoral sub-groups the latter may include.**

3.2.1.2 Joint Forum work

75. The Joint Forum recommended in its "*Review of the Differentiated Nature and Scope of Financial Regulation*"²⁹ (the "Review") that the 1999 *Joint Forum Principles for the supervision of financial conglomerates* be updated and expanded. The Review described the issue of "non-operating holding companies" and pointed out those jurisdictional differences in powers and requirements over an unregulated parent holding company pose challenges. It is noted that within the EU, the treatment of unregulated parent holding companies differs significantly across Member States, as evidenced by the stock take performed by the JCFC.

76. The New Joint Forum Principles started to tackle the issue above by giving a **definition of "top entity of the financial conglomerate"**:

"Unless otherwise specified [top entity of the financial conglomerate] means the entity which controls or exerts dominant influence over the financial conglomerate (the top entity of the financial conglomerate may be the ultimate parent, or may be the top entity of a financial conglomerate that is a subset of the wider group)";

and setting out a legal framework for the supervision of financial conglomerates taking care of all the entities within it, namely a framework which:

"should grant the necessary power and authority to supervisors (including the Group-level Supervisor) to: [...]1(a) identify, or set the parameters for the identification of a financial conglomerate and the entities within the scope

²⁹ Joint Forum, January 2010

of supervision, particularly those entities that could pose risks to regulated entities or the broader financial system" and [...] "1(e) access the Board and senior management of the top entity of the financial conglomerate and of the other material and relevant entities related to the financial conglomerate, to assess the risks and support available to the financial conglomerate".

3.2.1.3 The need for an ultimate responsible entity

77. Taking into consideration the EU and G20 developments, the identification of a responsible entity in a financial conglomerate seems a logical consequence, if it is considered necessary to ensure that supplementary supervision provides a comprehensive assessment of the risks stemming from the whole set of entities in a financial conglomerate (including non-regulated ones) and allows to avoid both duplication of requirements and the reduction of sectoral supervisory standards.
78. **Therefore, it is envisaged to identify a responsible entity according to criteria which are commonly applicable to regulated and unregulated top entities, operating and non-operating entities and to top entities either in the same sector as the main entities of the financial conglomerate or not.**
79. This proposal does not infer that all kind of entities should be subject to the same solo requirements when they are identified as "responsible" entities in a financial conglomerate; nor does it entail that the criteria for identifying the lead supervisor (the coordinator) of a financial conglomerate³⁰ should necessarily be amended when there is an unregulated entity at the top. There is some convenience in identifying the coordinator among those having an effective control on that entity.

3.2.2 Identification of problems and regulatory gaps

80. Although there might be issues with company law and other existing legislation in some countries, the analysis of the answers to the questionnaire conducted by the ESAs issued to the NSAs (see Annex A) indicates a large consensus among Member States on the need for the following:

³⁰ As provided in Article 10 FICOD / FICOD1

- clearer definitions for “unregulated entities” and “holding companies”;
- stronger and harmonised powers of supervisors on top unregulated entities of large and complex financial conglomerates;
- provisions for circulation of information within the companies within the same conglomerate which are practically implementable by the top entity and easily enforceable by supervisors.
- harmonised criteria for defining “group-wide responsibility” which at least provide that the responsible entity ensures that:
 - entities in the financial conglomerate provide requested information to supervisors;
 - the entities it controls undertake their operations prudently;
 - the overall structure of a financial conglomerate does not impede effective financial supervision;
 - the entities in the financial conglomerate have adequate internal governance frameworks (including for risk management and internal control and appropriate distribution of capital among the subsidiaries of a financial conglomerate), which are consistent with new Joint Forum Principles; and
 - a risk and recovery plan (as described in the European Commission crisis management requirements) is prepared at financial conglomerate level.³¹

3.2.3 The “ultimate responsible entity” of the financial conglomerate

3.2.3.1 Definition

81. Taking stock of supervisors’ experiences and suggestions with respect to supervisory powers over financial holding companies and building upon the reported consensus on the ideas of “group-wide responsibility”, it is proposed that the enhancement of supervisory effectiveness with respect to financial conglomerates’ compliance with group-wide requirements is pursued by designating an “ultimate responsible entity”.

82. This entity will be understood to be **“the legal entity steering and controlling regulated entities belonging to the financial conglomerate”**. This is not a legal definition, but a principle for identifying a set of minimum criteria (see subsection 3.2.3.2 below for practical proposals

³¹ See also Article 9.2(d) of the FICOD1 “arrangements in place to contribute to and develop, if required, adequate recovery and resolution arrangements and plans. Such arrangements shall be updated regularly.”

of these criteria) which builds upon the EU legislative framework, the new Joint Forum Principles definition and the virtual structure of the financial conglomerate.

3.2.3.2 Minimum criteria for qualification

83. When the conditions for being a financial conglomerate are fulfilled and independently from the nature (unregulated/regulated, operating/non-operating) of the top entity, it is proposed that the ultimate responsible entity is identified according to the following minimum criteria referring to the “internal” relationships **within the ultimate responsible entity and the other entities of the group** (case a); to the relationships of the ultimate responsible entity **outside the group** (case b); and, finally, to the **steering and directing abilities of the ultimate responsible entity** (case c).
- a. Control: It is presumed that the ultimate top company of the financial conglomerate, exercising a legal or de facto control over most of the entities of the group, is the driver for the activities of the whole group. Accordingly, in general, the ultimate responsible entity should be the ultimate parent company³².
 - b. Market counterparty/ listed entity: Where a financial conglomerate is listed on a stock market, the listed entity is likely to be the ultimate top parent entity and, is in principle qualified as ultimate responsible entity. However, if the financial conglomerate includes a company that, although not being the ultimate company, influences through its relations with the market the overall setting (in terms of both structure and strategy) of the group, then such company would be qualified as ultimate responsible entity.
 - c. Ability: In cases where there are no control relationships (e.g. horizontal groups) or in cases when no single decision making entity can be identified (for example, when company law provides for particular governance agreement under which direction is exercised in consensus with controlled entities), the criteria for identification of the ultimate responsible entity will relate to the ability to perform specific duties

³² In case of groups formed by institutions permanently affiliated to a central body as in Article 3 of the CRD3, the central body referred to should be the responsible entity. The ultimate responsible entity identification might be helped by the Legal Entity identifier.

towards the supervisors and the other entities within the group. When the ultimate parent does not have such ability, it will explicitly and in due forms indicate which entity within the financial conglomerate possesses this ability.

84. The ultimate responsible entity identification process might usefully take into account two other possibilities:

d. Non-financial conglomerates: Where regulated entities are linked together because they have the same non-financial parent, these entities can be considered by the competent authorities as a financial conglomerate (according to Article 4 FICOD and if all conditions of Article 3 FICOD are met³³) over which supplementary supervision could be exercised. In these cases, supervisors may want to have some knowledge of the non-financial parent's situation. This **need for information from the non-financial parent** is underlined also by Joint Forum Principle 11 ("Watching over the structure of a financial conglomerate") of the new Joint Forum Principles (see also Annex F). This knowledge could be achieved through several instruments, which can be used, for example:

- create an **intermediate financial holding** to whom duties towards supervisors and subsidiaries are explicitly delegated and which would be qualified as ultimate responsible entity of the financial conglomerate (see tool 1, paragraph 66).
- define specific requests for the industrial top entity, either or not within a specific written agreement among the industrial entity and the supervisors of the financial part of the group **one point of entry** (tool 2, paragraph 67), which may set for example: the schedule for the provision of regular information to supervisors, the type of information to be provided and any other requirements which might ensure that the overall structure of the conglomerate does not impede effective supervision; or the designation of a **regulated entity as point of entry** (tool 3, paragraph 68), disregarding its legal personality, at the entity of the financial part

³³ Among these conditions there is the one requesting a material size for the financial business of the subsidiaries of groups headed by non-financial parent (i.e.: the 40% threshold). This is a way not to excessively enlarge the scope of financial supervision. However, it has to be recognised that the number/threshold which defines "materiality" might always have an arbitrary nature.

of the conglomerate who is suitable to be identified as ultimate responsible entities.

- e. Third country (non-EEA) conglomerates: Where a conglomerate is headed by an ultimate parent that is incorporated in a non-EEA State, the identification of the ultimate responsible entity should fulfil the qualifying criteria (a, b and c above) with respect to the highest EEA parent company. Where a single non-EEA conglomerate has more than one EEA sub-group, then further rules would need to be identified to select a unique ultimate responsible entity among those within each EEA sub-group.

3.2.3.3 Responsibility for identification of the ultimate responsible entity of a financial conglomerate

85. FICOD/FICOD1 already provide that the coordinator³⁴ identifies within the financial conglomerate an entity responsible for the submission of the information needed for the exercise of supervision on capital adequacy, risk concentration and intra-group transactions.
86. In FICOD2 the determination process of the ultimate responsible entity could be made clearer by either:
- fixing criteria the coordinator could follow for selecting the ultimate responsible entity;
 - fixing the principles for discussing the selection with the financial conglomerate itself and the other relevant competent authorities; or
 - providing the financial conglomerate with the right - subject to the consent of the coordinator - for selecting the ultimate responsible entity. In this case FICOD2 has to specify under which conditions the supervisors' consent could be met and what should be the process to decide if the supervisors disagree.

³⁴ As determined by Article 10 FICOD.

3.2.4 Requirements for ultimate responsible entities

87. This section discusses why internal governance is a crucial element for an enhanced supplementary supervision. In particular, (i) the existing EU requirements with respect to the risk management of a financial conglomerate (including capital adequacy policies, risk concentration and intra-group monitoring and reporting) and corporate governance (including internal controls) are analysed in order to make proposals for their improvement in the context FICOD2. For detailed information Annex F provides an analysis of the relevance of the EU requirements and the new Joint Forum Principles in term of top level supervision

3.2.4.1 Relevant provisions of the Financial Conglomerates Directive

88. In order to strengthen responsibility of top parent entities it is suggested to elaborate the requirements provided in Articles 6 (2) subparagraph 1 and Articles 7, 8, 9 and 13 FICOD. The provisions could be further enhanced.

Possible enhancement of EU capital management requirements

89. In many cases this ultimate parent undertaking is a listed entity (and therefore raises core capital through share equity) or is the entity which attracts a credit rating (and therefore the entity which drives the conditions at which capital could be raised externally). In these cases, the ultimate parent undertaking (which could be a MFHC, a FHC, an IHC or a regulated entity depending on the group structure) will inevitably exercise some control on the group's capital management policies.

90. It might be appropriate to explore whether FICOD2 should to specify how capital management duties might be performed by such ultimate parent undertaking and how the latter could be held responsible that overall group capital policies are adequate.

91. More specifically, FICOD 2 might need to specify that the responsibility for overall group capital policy does not mean that the ultimate unregulated financial parent undertaking is itself subject to sectoral solo capital requirements or to a capital requirement which is different from the theoretical one set for MFHC by Annex 1 of FICOD.

92. This responsibility might possibly entail that:

- the ultimate responsible entity is required to ensure that regulated entities within the financial conglomerate do not breach sub-consolidated and solo capital requirements without absolving their individual responsibility for capital management;
- additional supervisory measures will be made available in relation to the regulated entities if breaches occur at the group level and vice versa in relation to the top entity if breaches occur at solo level;
- both solutions above are provided to supervisors.

Possible enhancement of EU reporting requirements

93. **Looking at the substance** of the reporting provisions in the sectoral Directives, it seems suitable to **extend the responsibility for reporting at least significant risk concentrations and significant intra-group transactions to the ultimate responsible entity**.
94. In order to give a specific content to such reporting duty and to harmonize the responsibility of the reporting entity, it is essential to clarify which risk concentrations and intra-group transactions should be reported. In this respect Articles 2 (6) lit. b and 2 (7) lit. b FICOD1 (amending Article 7 and 8 FICOD) provide an important solution requesting the ESAs, through the Joint Committee, to issue common guidelines aimed at the convergence of supervisory practices with regard to the application of supplementary supervision of risk concentrations and intra-group transactions. These guidelines should also aim at making supplementary supervision on risk concentration and intra-group transactions aligned with the application of the corresponding sectoral provisions³⁵. At this juncture it might, therefore, be premature to specify requirements for ultimate responsible entities with reference to the reporting duties on risk concentration and intra-group transactions.
95. Accordingly, at this stage it should be sufficient to include in FICOD2:
- provisions which detail the duties of the ultimate responsible entity on reporting these phenomena, which from a top level supervision point of view should enable supervisors to develop an assessment not only at the

³⁵ See Articles 106 to 118 of Directive 2006/48/EC and Article 244 of Directive 2009/138/EC

level of outstanding exposures, but also on how financial resources move throughout the financial conglomerate (e.g. from some entities/sectors towards others; from one country to another; from regulated to unregulated entities; from controlled toward participated entities);

- provisions which better specify the scope of Article 14 FICOD. FICOD2 could include provisions that guarantee the activation of article 14 of the directive should the ultimate responsible entity not take the necessary steps to ensure compliance with the financial conglomerate directive and not implement, calculate, report to the coordinator group wide requirements, on behalf of all entities included in the supplementary supervision. This article provides Member States with a very strong tool to remove obstacles to information sharing among the entities belonging to a financial conglomerate, and therefore, is the provision to refer to when requesting that risk concentration and intra-group transactions are reported by the ultimate responsible entity with respect to the whole group.

Possible enhancement of governance requirements

96. In order not to lower supervisory standards and for an efficient top level supervision it is essential that governance requirements are effectively made equivalent regardless the sector in which the parent and the subsidiaries are respectively active.
97. The recent EBA Guidelines on internal governance³⁶ and the implementation measures of Solvency II on the same subject provide valuable direction for reinforcing financial conglomerates governance. Additionally, the on-going works related to the implementation of Solvency II could provide helpful inputs.
98. These suggestions in the field of corporate governance considered in conjunction with the coordinating and directing role to be assigned to the ultimate responsible entity of the financial conglomerate as suggested by the new proposed Joint Forum Principles on risk management and governance

³⁶ For example the Guidelines on organisational framework (4), checks and balances in a group structure (5), know-your-structure (6) and non-standard or non-transparent activities (7) could be usefully reflected in the governance requirements for the management board of the ultimate responsible entity of a financial conglomerate (see suggestions in Section 5 below). Published on 26 September 2011 – See: [http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2011/EBA-BS-2011-116-final-\(EBA-Guidelines-on-Internal-Governance\)-\(2\)_1.pdf](http://www.eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2011/EBA-BS-2011-116-final-(EBA-Guidelines-on-Internal-Governance)-(2)_1.pdf)

(see subsection 3.2 below) will contribute to the effective enhancement of top level supervision on financial conglomerates.

3.2.5 Proposals for duties and responsibilities to be assigned to ultimate responsible entities

99. Following the analysis of the FICOD and the new Joint Forum Principles and building upon the minimum consensus emerged from national answers to the JCFC questionnaire with respect to “group-wide responsibility” (see also Annex A), possible “responsibilities” to be assigned to the ultimate responsible entities are:

- a) Acting as a reference point for supervision, fulfilling reporting obligations towards supervisors for the whole conglomerate; and**
- b) Providing consolidated accounts for the whole Financial Conglomerate.**

100. It is proposed that the **scope of these duties covers “participations”**. This would take into account the fact that FICOD/FICOD1 already provides that some “supplementary supervisory” tools have a wider scope than the one generally entailed by the equivalent supervisory tool at sectoral level.³⁷

Other responsibilities that Members States suggested to be assigned to ultimate responsible entities were inter alia:

- c) Ensuring adequate group structure and organisation, so that the supervision of each entity in the conglomerate, the exchange of information among group entities, and the performance of duties listed under lit. a. and b. above are not impeded.** This duty strengthens the idea that the autonomous choices of groups with respect to their internal structure and governance cannot put at risk (or be prevalent on) the objectives of supervision, both on each entity in the financial conglomerate and on the group.
- d) Fulfilling a coordinative and directive role towards other entities in the group.**

³⁷ For example, the scope of application of intra-group transactions (“IGT”) and risk concentrations (“RC”) supervision is very wide and also includes entities (even unregulated) that can be related to entities within the financial conglomerate only by means of participation of 20% or without percentage participation at all. With respect to IGT, the scope of application includes also physical persons

e) Ensuring that the conglomerate complies with conglomerate level requirements.

101. These duties are related to two objectives: one relates to supervisors' need for a single point of entry with respect to specific intervention (including those in stressed and emergency situations) on the financial conglomerate³⁸ (see also Part 1, paragraph 67); the other relates to groups' need for having an internal organization which ensures compliance with supervisory rules both at solo and group level (see also paragraph 108, box 4 below).

3.2.6 Translation of duties and responsibilities into requirements

102. The before mentioned duties and responsibilities might be translated into different layers of requirements, varying according to the nature of the ultimate responsible entity (operating vs. non-operating) and, when operating, whether it exercises either the same or a different business with respect to the other entities of the group.

103. Different layers of requirements might also be envisaged in consideration of the kind of link between the ultimate responsible entity and the other entities of the group, for example participated (but not controlled) entities. In case the ultimate responsible entity delegates the operation of these duties to an entity of another group, the control of this outsourcing procedure is to be required and properly documented to the supervisor.

104. With no ambition of being exhaustive, in the following paragraphs there are some suggestions (examples) on how translating the above mentioned duties/responsibilities into corporate governance requirements for ultimate responsible entities of financial conglomerates. These requirements are divided into those towards the supervisors and those towards the other entities in the conglomerate.

Responsibilities towards supervisors

105. Without prejudice to sectoral supervision exercised at solo and group level, the ultimate responsible entity of the conglomerate should be the reference point for supervision at the level of the conglomerate. This means that the ultimate responsible entity should:

³⁸ In this case, the ultimate responsible entity may coordinate within the group the specific actions required by the supervisors.

- prepare and submit information and data at conglomerate level to the coordinator/group supervisor (reporting obligation). It should include qualitative information on the coordinating and managing activities carried out by the ultimate responsible entity towards the entities of the conglomerate;

BOX 1: An example of reporting requirements which the ultimate responsible entity could be assigned responsibility:

- a) reporting significant risk concentrations and intra-group transactions;
- b) producing guidelines on internal control mechanisms and risk management process applicable at the level of the conglomerate (Art. 9 (6) FICOD);
- c) ensuring, according to the guidelines referred in point b) above, compliance with qualitative/quantitative limits on conglomerate level risk concentrations and intra-group transactions set by the coordinator.

- ensure that the structure of the conglomerate and the business it carries out do not undermine the ability of the ultimate responsible entity to assess the risk profile and compliance with supervisory requirements at conglomerate level;

BOX 2: Example of the requirements on the activity and structure of the conglomerate – awareness of the management board of the ultimate responsible entity.

The management board of the ultimate responsible entity of the financial conglomerate should ensure that:

Appropriate organisational framework

The structures within the financial conglomerate are suitable, clear and transparent, both to its own staff and to its supervisors, and do not impede the ability of the management board to oversee and effectively manage the risks the financial conglomerate faces.

Checks and balances in a group structure

It has the overall responsibility for and oversight over adequate internal governance across the financial conglomerate and for ensuring that there is a governance framework appropriate to the structure, business and risks of the financial conglomerate and its component entities, while respecting the independent legal and governance responsibilities that apply to regulated subsidiaries' management boards.

Know-your-structure

It fully knows and understands the operational structure of the financial conglomerate and that the legal entity's structure is justified and does not involve undue or inappropriate complexity.

Know-your-business

It has understanding of financial conglomerate-specific operational risks, intra-group exposures and how funding, capital and risk profiles could be affected under normal and adverse circumstances.

Non-standard or non-transparent activities

Where a financial conglomerate operates through special-purpose or related structures or in jurisdictions that impede transparency or do not meet international supervisory standards, the management body shall understand their purpose and structure, the particular risks associated with them and only accept these activities when it has satisfied itself the risks will be appropriately managed.

- ensure compliance of the conglomerate structure with general internal control principles such as those entailed in EBA's guidelines.

BOX 3: Example of practical content of the requirements for an internal control system to be set at conglomerate level³⁹

Respecting sectoral requirements applicable to regulated entities within the conglomerate, the parent undertaking should set up a system of internal control for the conglomerate, which should be adequate for carrying out effective control over the conglomerate's overall strategic choices and for balancing the management of each individual entity and of each sectoral subgroup within. In particular, the top responsible undertaking should establish:

- formalised procedures of coordination and linking (also as regards information) between the companies belonging to the conglomerate and the parent undertaking for all the areas of business;
- mechanisms for integrating the accounting systems, also with the aim of ensuring the reliability of the registered items on a consolidated basis;
- periodical information flows which allow the achievement of strategic objectives and the compliance with regulations to be verified;
- highlighting and accounting procedures which allow the (intra-group) transactions between entities in the conglomerate to be checked, quantified, monitored and controlled;
- procedures which ensure the consistency between the data and information produced for the purposes of consolidated/group supervision at sectoral level and those produced for the purposes of supervising the conglomerate;
- the definition of tasks and responsibilities of the various units assigned with the control of risks within the conglomerate and the mechanisms for coordination; and

³⁹ The examples in the box giving practical content to internal control mechanisms and risk management processes to be set up at the level of the ultimate responsible entity stems from existing corporate governance regulation in a Member State.

- procedures that are appropriate for ensuring, in a centralised form, the identification, measuring, management and control of risks at conglomerate level.

106. The coordinating and directing role of the ultimate responsible entity is linked to specific governance arrangements among the entities in the conglomerate. These arrangements should not only guarantee the directing role of the ultimate responsible entity but also serve the purposes of prudential supervision and cannot be used against the purposes of solo supervision, or against the interest of the subsidiaries.

Requirements towards the entities in the conglomerate

107. Within the perspective used to analyse the new Joint Forum Principle 13 (see Annex F) which ensures that the ultimate responsible entity takes into account – through governance arrangements – the legal, regulatory and prudential rules of regulated subsidiaries, the ultimate responsible entity has a coordinating and directing role towards the subsidiaries belonging to the conglomerate.

108. This role serves the purposes of prudential supervision and cannot be used to impose policies on subsidiaries that would run against the purposes of solo supervision, nor against the interests of the subsidiaries themselves or their own stakeholders. This role could be given practical contents following the examples in box 4 below:

BOX 4: Example of practical content of coordinating and directing role that the ultimate responsible entity would have to exercise on subsidiaries

Within the scope of specific governance agreements and internal control procedures of the conglomerate, the ultimate responsible entity could:

- Coordinate and direct the development of the various areas of business in which the conglomerate operates and the risks related to them, including the expansion of business carried out by the undertakings belonging to the conglomerate and the policies relating to acquisition or sale of undertakings in the conglomerate;
- Coordinate and direct the financial conditions of the individual undertakings belonging to the conglomerate, or the sectoral subgroups composing the conglomerate, so that the conglomerate as a whole is sufficiently sound; and
- Coordinate and direct the various risk profiles that each controlled undertaking brings into the conglomerate so that they are consistent with the overall risk profile and risk appetite of the conglomerate.

109. The coordinating and directing role exercised by the ultimate responsible entity towards the entities in the conglomerate may include the adoption of written policies to implement the general and specific provisions set by supervisors and, in the context of governance internal agreements within the

entities of the conglomerate, might also include verification (through the internal audit functions and the internal control systems) of subsidiaries' compliance with the guidelines of the ultimate responsible entity. Written policies should get approval by the Board at subsidiary level (see, for example, box 5, where possible ways of documenting the directing role of the ultimate responsible entity are suggested).

110. The coordinating and directing role may include that the ultimate responsible entity ensures a consistent assessment, measurement and valuation of the risk profile of the conglomerate. This assessment should also include data/information/risks stemming from participated entities (not only subsidiaries)⁴⁰. Without prejudice to the requirements set up by sectoral rules at solo and group level on regulated entities, the ultimate responsible entity may therefore formalize and inform all the companies in the conglomerate about the criteria used to identify measure, manage and control all risks at conglomerate level, including validation of the control systems and procedures within the conglomerate.

BOX 5: Information on the coordinating and managing role exercised by the ultimate responsible parent.

The ultimate responsible entity may keep evidence (available also to the coordinator, if required) of:

- written policies adopted in agreement with the other entities of the group in order to implement laws/guidelines /supervisory instructions at conglomerate level;
- instructions given to the group subsidiaries in the performance of the direction and coordination activities;
- internal control mechanisms and risk management processes adopted in compliance with the above mentioned instructions and the relevant implementing provisions regarding internal control and risk management; and
- outcomes of the verification of subsidiaries' compliance with the ultimate responsible entity's instructions and guidelines issued for the purposes of coordinating and managing the conglomerate.

Potential implementation within FICOD2 of the said ultimate responsible entities' duties and related requirements

111. The enhancement of financial conglomerates' governance requirements on the ultimate responsible entity could be realised through some changes on the existing EU legislative framework. These changes could consist of

⁴⁰ Article 14 FICOD/FICOD1 is considered to offer room for this role to be exercised towards participated entities. This Article might be made more practically implementable thanks to the guidelines which Articles 2 (6) lit. b and 2 (7) lit. b FICOD1 request ESAs to provide with reference to supplementary supervision of risk concentration and intra-group transactions of participated entities within a conglomerate.

introducing additional requirements for the ultimate responsible entity with reference to i) the coordinator and ii) the entities belonging to the group, separately for subsidiaries and participated entities.

112. These changes may imply either amendments to existing articles in FICOD/FICOD1 or brand new Articles. In this respect, it is suggested how to steer these new pieces of legislation, which obviously require expert investigation by the European Commission Services. Most specifically: the current framework could usefully include **a new definition for the “ultimate responsible entity”** of any group and the criteria for its identification along the lines suggested in Part 2, subsection 3 of this advice and the **amendments/new Articles to FICOD/FICOD1** could involve for example:

- a) making the ultimate responsible parent (either additionally to regulated entities, or exclusively) responsible for the conglomerate level requirements contained in existing Articles such as 6, 7, 8 and 9 which are currently applied only to regulated entities.

EXAMPLE: Amending Article 9 (1) FICOD (and the other Articles along the same lines):

“Without prejudice to the provisions on supervision over regulated entities contained in the sectoral rules, Member States shall require regulated entities and the ultimate responsible entity to have in place at the level of the financial conglomerate, adequate risk management processes and internal control mechanisms, including sound administrative and accounting procedures.”

or

“Without prejudice to the provisions on supervision over regulated entities contained in the sectoral rules, Member States shall require ~~regulated entities~~ the ultimate responsible entity to have in place at the level of the financial conglomerate, adequate risk management processes and internal control mechanisms, including sound administrative and accounting procedures.”

- b) Adopting the wording of the requirements listed in box 3 above to enhance the current requirement in FICOD1 on ‘adequate risk management processes and internal control mechanisms, including sound administrative and accounting procedures’.
- c) Adopting the wording of requirements listed in box 2 above to enhance current FICOD1 requirements to be applied to the management board of the ultimate responsible entity.

Part 3

3.3 Strengthening sanctions and enforcement under FICOD

3.3.1 Overview of the current regime

113. **Article 16 FICOD** governs enforcement measures for financial conglomerates. However, this Article only refers to the fact that '**necessary measures shall be required to rectify the situation**' but does not specify such measures. In addition, on the basis of the Omnibus I Directive, the ESAs have received the possibility to develop **guidelines**⁴¹ for measures in relation to mixed financial holding companies, but these guidelines have not been developed so far.
114. This means that currently there is **no EU-wide enforcement framework** specifically designed for financial conglomerates. As a result, supervision of financial conglomerates is sectoral-based with differences in national implementation.

3.3.1.1 Sectoral-based approach

115. Supervisory experience shows that supervision of financial conglomerates is primarily based on the sectoral regime in which the particular financial conglomerate is dominant. This means that banking-led conglomerates are supervised from a CRD perspective and insurance-led conglomerates from a Solvency perspective. Supervisors indicate that they generally consider this sectoral-based approach to be sufficiently effective to perform their duties.
116. Furthermore, group supervision under Solvency II and CRD IV will be further enhanced with regard to the different relevant aspects of FICOD (for details please refer to **Annex G**). This strengthening of group supervision may further reinforce the tendency of supervisors to conduct the supervision of financial conglomerates on the basis of sectoral regulation. At the same time, it will remain important to fully take into account the requirements under FICOD to give adequate attention to the supplementary risks within a financial conglomerate.

⁴¹ See Article 12b (2) FICOD

117. Second, even under the strengthened sectoral Directives, it may not always be possible to effectively enforce compliance of the group. **Article 17 FICOD** determines that in addition to sectoral enforcement measures, supervisors should have powers to prevent practices within the group that are likely to circumvent sectoral rules (especially, the use of regulatory arbitrage). In addition, supervisors should be able to impose enforcement measures towards the ultimate responsible parent within a mixed financial holding company.
118. Third, a sectoral-based approach may lead to differences in the treatment of financial conglomerates, depending on whether the conglomerate is insurance or banking-led. Currently, there are differences in regulation between the banking and insurance sector. CRD is more prescriptive than Solvency II. Moreover, the CRD IV proposal from the European Commission contains an important strengthening of the sanctioning regime and is more detailed in the sanctions that should be applied. Although these CRD IV proposals are still under discussion, this strengthening of the enforcement regime may create an unlevel playing field between financial conglomerates.

3.3.1.2 Differences in national implementation

119. Another consequence of the **open formulation of Article 16 FICOD** is that the availability and the application of enforcement instruments towards financial conglomerates may vary between Member States.
120. On the request of the European Commission, CEBS, CEIOPS and CESR made an overview of the available instruments and use of sanctioning powers⁴². These surveys show that the available toolkit to supervisors is similar, but also presents some differences. These differences increase when the situation of the institution is more problematic and the supervisory measures become more far-reaching. On the actual use of sanctioning powers, it is more difficult to come to unified conclusions, partly because of a lack of common understanding of the definition of sanction, despite the European Commission's recent efforts to develop a broad notion of sanction⁴³. This will

⁴² CEBS 2009(47): Mapping of supervisory objectives and powers, including early intervention measures and sanctioning powers and CEIOPS 21/09: "Report to the European Commission on EU supervisory powers, objectives, sanctioning powers and regimes".

⁴³ Cf. Communication "Reinforcing sanctioning regimes in the financial services sector" COM 2010 (716) final, esp. 2.1.: "This communication refers to "sanctions" as a broad notion covering the whole spectrum of actions applied after a violation is committed, and intended to prevent the offender as well as the general public from committing further infringements."

be taken up in the initiative of the European Commission to reinforce sanctioning regimes.

121. Following up on the stocktakes of the former Level-3-Committees, the European Commission reviewed the sanctioning regimes between Member States. It revealed differences with regard to the availability of sanctioning powers, the form and substance of available instruments, the level of application and the actual use of enforcement powers. Based on that analysis, the European Commission concludes that these differences may undermine the quality of financial supervision within Europe and the functioning of the single market. It therefore seeks further harmonisation. This resulted in a communication of the European Commission to promote convergence of sanctions across the range of supervisory activities⁴⁴.

3.3.2 Considerations

122. Based on the observations with regard to the current regime, there seems to be room for strengthening the enforcement framework for financial conglomerates. The objective is to promote a comprehensive approach towards the group and to stimulate a conglomerate to have a risk strategy that is consistent and coherent for the entire group. Enforcement measures should enable the supervisor to effectively address these risks at the level of the group. Also, regulatory arbitrage between sectors as well as between Member States due to differences in national implementation should be diminished or best be eliminated.

123. The strengthening of FICOD should be in line with the revised Joint Forum Principles:

- Joint Forum Principle 1 (comprehensive group-wide supervision): the legal framework for the supervision of financial conglomerates should grant supervisors (including the group-level supervisor) the necessary powers and authority to enable comprehensive group wide supervision.
- Joint Forum Principle 8 (monitoring and supervision): supervisors should develop and maintain a sound understanding of the operations of financial conglomerates through undertaking a range of appropriate supervisory activities.

⁴⁴ http://ec.europa.eu/internal_market/consultations/docs/2010/sanctions/COM_2010_0716_en.pdf

- Joint Forum Principle 9 (supervisory tools and enforcement): supervisors should, when appropriate, utilise supervisory tools to compel timely corrective actions and/or enforce compliance of financial conglomerates with the prudential framework.

3.3.3 Proposed way forward

124. Effective supervision should be able to timely detect, prevent and mitigate risks that originate within a financial conglomerate as a result of its cross-sectoral nature. To strengthen enforcement towards financial conglomerates, the following steps could be considered.

3.3.3.1 Strengthening group-wide view and focus on supplementary risks

125. The changes of FICOD1 enable supervisors to apply banking consolidated supervision, insurance group supervision and supplementary supervision at the same time at the level of the holding company. Building upon these changes, supervisors should be able to take **preventive and corrective measures at group level** against risks that derive from the group as a whole. In this regard, it is worthwhile to emphasize that the FICOD focuses upon supplementary risks posed by a financial conglomerate.

126. As a basic principle, the solvency position of the group and its underlying entities should be adequate. This means that in addition to the capital requirements for each subsector - that follow from the applicable sectoral rules - the supervisor should be able to prevent transactions that result in multiple gearing or the use of regulatory arbitrage. Information that would be useful in this respect could inter alia include: i) information on financial guarantees between the entities of the group ii) liquidity facilities iii) equity exposures and iv) debt exposures. This is currently captured by Article 17 (1) FICOD. In addition, supervisors should be able to impose **additional capital requirements** (notional amount) **for supplementary risks**. For example, this could be the case if the group structure is not transparent or in case other activities within the group may undermine adequate risk management or jeopardize the solvency position of the group. Also, requirements could be strengthened in order to ensure that equity capital for the group can only be included in case it is effectively transferable and available among the various group members.

127. In addition, the conglomerate should not accumulate risk concentrations and intra-group positions that may undermine the financial stability of the group. These are risks that may typically develop at the level of the group as a result of the cross-sectoral nature of a conglomerate. A report of the Joint Forum⁴⁵ notes that most financial conglomerates are still managed within separate risk categories and within business lines. Further, the report states that it is important for conglomerates to have an integrated risk management across risk categories. The group structure may lead to less risks as a result of diversification effects or increasing risks as a result of correlations and risk concentrations. In order to make these mitigating or amplifying effects more visible, it could be useful to **strengthen risk management with a group-wide perspective** on the basis of the specific ESAs guidelines as indicated in Article 9 (6) FICOD or through stress tests on a group wide level as provided by Article 9b FICOD.

3.3.3.2 Effective enforcement regime

128. As the European Commission indicated in its communication, the sanctioning regime should be dissuasive⁴⁶. This means that sanctions should be sufficiently serious to deter violations and induce entities to take corrective action. The current national enforcement regimes are derived from sectoral Directives and cover a broad range of available measures (see box).

Examples of available enforcement measures under sectoral legislation:

Available enforcement measures

There is no unified toolkit for enforcement between Member States. The overview⁴⁷ of work performed by CEBS and CEIOPS showed a wide variety of available measures throughout the EU. The most common supervisory measures that are applied among supervisors are listed below (not exhaustive) and can be classified as preventive or corrective measures:

Preventive measures

- Submit supervised institutions to on-site inspection
- Require supervised institutions to provide information
- Require more strict supervisory requirements (e.g. capital, liquidity)

⁴⁵ Joint Forum (2008): *Cross-sectoral review of group-wide identification and management of risk concentrations*

⁴⁶ The CRDIV proposal for example includes a provision on the publication of sanctions (article 68) and addresses administrative pecuniary sanctions (article 67.).

⁴⁷ CEBS 2009 (47): Mapping of supervisory objectives and powers, including early intervention measures and sanctioning powers and CEIOPS 21/09: "Report to the European Commission on EU supervisory powers, objectives, sanctioning powers and regimes".

- Require an institution to enhance its governance
- Restrict the business conducted by the institution
- Require the institution to adjust its risk profile
- Require the institution to take certain mitigating actions
- Limit intra-group transfers and transactions
- Limit asset transfers and transactions outside the group
- Require a supervised institution to submit a recovery plan

Exercise supervisory forbearance

Corrective measures

- Issue a public warning of reprimand
- Withdraw all or part of the license
- Suspend all or part the exercise of activities
- Oppose / suspend (nomination of) board member or managing director
- Appoint a special administrator: a person or body with power to act and take decisions
- Require the transfer of shares /change in ownership
- Prohibit or limit the distribution of profits or other payments
- Control or a play role in reorganisation or winding-up
- Initiate insolvency proceeding
- Refer actions of the institution to judicial authorities
- Publication of sanctions

129. Responses to the ESA’s questionnaire (see Annex A) indicated that most national supervisory authorities consider the available measures for sectoral supervision also appropriate for the supervision of financial conglomerates. Strengthening the supervision of financial conglomerates could be achieved through an improvement of the actual use of the instruments and, in some cases, the reinforcement of the existing measures. In addition, it is important to maintain a level playing field between insurance-led conglomerates and bank-led conglomerates.

130. With regard to the actual use of enforcement measures, it is noted by the European Commission that the use of sanctioning powers differs between Member States. Although the use of supervisory measures constitutes an important element in the quality of supervision, it is not further discussed in this paper, given it reflects different national choices with regard to the individual supervisory approach.

131. With regard to the scope of application, supervisors should have more power to enforce compliance towards the level of the group which is ultimately responsible, where enforcement of compliance is most effective (see Part 2, paragraph 69).

132. There are different approaches between Member States. Some supervisors can apply measures directly towards the (non-regulated) holding company (direct approach), whereas others apply enforcement measures only through the regulated entities within the group (indirect approach). Both approaches have their merits. Regulated entities have received a license and fall under the mandate of the supervisor; therefore they should take responsibility for the impact of their activities on the group. Moreover, from a legal perspective, it is essential that sanctions and enforcement measures are imposed on those entities that are actually responsible for breaking a group-wide requirement. On the other hand, the parent of the conglomerate is the entity that is ultimately responsible for the strategic decisions of the group and is responsible for group-wide risks (see Part 2 paragraph 77).
133. This would imply a **combination of enforcement powers towards the top entity of the conglomerate** for group-wide risks in their role as a parent and enforcement powers towards the regulated (sectoral) entities in their role as subsidiaries. This would be in line with the approach under Article 120 CRD IV: "Member States shall ensure that sanctions or measures aimed at ending observed breaches or the causes of such breaches may be imposed on financial holding companies, mixed financial holding companies, and mixed activity holding companies or their effective managers (...)". Enforcement towards the top entity would only apply to responsibilities that relate to their group-wide responsibilities.
134. The specific instruments that should be available towards the top entity of the conglomerate differ between the two options that are presented within part 1 and 2 of this report.

Intermediate financial holding (Tool 1, see paragraph 66)

135. If it were required to create an intermediate financial holding company, this would also be the main entity that is responsible for group-wide risks. Enforcement of group wide requirements would then also need to be directed towards this intermediate financial holding company.
136. Available measures could be in line with existing regimes of CRD IV and Solvency II towards financial holding companies or insurance companies, except that the intermediate financial holding would not require a license as long as it does not perform financial activities of its own. With regard to the supervisory powers that should be available to address supplementary risks at level of the intermediate financial holding company, it would be necessary to create a minimum set of sanctioning measures. This could for example

follow the proposed powers under Article 64 of the CRD IV Proposal.⁴⁸ The application of the powers under CRD IV to the insurance-led conglomerates could imply inconsistency with the current regime provided under insurance sectoral rules (Solvency II).

One point of entry (Tools 2 and 3, see paragraph 67 and 68)

137. If it is not required to create an intermediate financial holding company for its financial activities (see option 1), the current situation will continue to exist where the ultimate parent of a financial conglomerate may be a mixed activity holding company. In this case, **Tool 2** requires to designate, at the top unregulated entities, one **“point of entry”** within the industrial group, in lieu of a formal ‘common chapeau’ of the financial entities in the group, this point of entry is not a legal person, but a single reference for the supervisors. **Tool 3** consists in designating a **regulated entity as point of entry**: the genuine responsible entity for performing the specific duties towards the supervisors is the legal addressee of supplementary supervision, though it is not at the top of the financial conglomerate.
138. Responses from the ESAs’ questionnaire to NSAs indicate that most countries support the idea of a single point of address for group-wide risks on one way or the other. In order not to extent supervision too much towards non-financial activities, available powers towards the group should be limited to the extent that it is necessary to capture the financial risks within the financial conglomerate. This includes **preventive measures like i) performing on-site inspections ii) gathering information and iii) reporting requirements** (both regular and ad-hoc).

⁴⁸ Article 64 CRD IV Proposal of July 2011 states:

“[...] Competent authorities shall have at least the following powers:

(a) to require institutions to hold specific own funds...

(b) to require the reinforcement of the arrangements, processes, mechanisms and strategies implemented to comply with Articles 72 to 74;

(c) to require institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements.

(d) to restrict or limit the business, operations or network of institutions or to request the divestment of activities that pose excessive risks to the soundness of an institution;

(e) to require the reduction of the risk inherent in the activities, products and systems of institutions;

(f) to require institutions to limit variable remuneration as a percentage of net revenues when it is inconsistent with the maintenance of a sound capital base;

(g) to require institutions to use net profits to strengthen own funds, including by restricting or prohibiting distributions to shareholders or members by the institution;

(h) to impose additional or more frequent reporting requirements, including reporting on capital and liquidity positions;

(i) to impose restrictions on maturity mismatches between assets and liabilities; and

j) to prohibit the payment or distribution of dividend or interest on Additional Tier 1 instruments”.

139. The ultimate responsible entity would be responsible for managing group-wide risks within the group. The ESAs recognise that national company law may set limits to the capacity of the holding company to collect information within the group, which should be fully respected. However, it still remains the responsibility of the group to have in place "adequate risk management processes and internal control mechanisms" as currently described in Article 9 FICOD. This could be achieved by means of i) voluntary agreement on information sharing within the group ii) steps to promote the implementation of Article 14 FICOD which states that "Member States shall ensure that there are no legal impediments from exchanging information", or iii) supervisory measures to address the adequate control of prudential risks (including the possibility to apply the deduction method for associated risk). Corrective measures towards mixed activity holding companies would be restricted and primarily focus on issuing a public warning and taking measures against a holding company or group structure that is considered not appropriate to effectively control financial risks. This could be enforced by requiring a transfer of ownership, change in governance, or – ultimately – through a withdrawal of a declaration of non-objection.

3.3.3.3 Strengthen national implementation

140. As the financial crisis has shown, the European financial market is strongly integrated. The European Commission therefore tries to converge financial regulation within the EU in order to strengthen the level playing field and to avoid regulatory arbitrage. The Solvency II Directive will give an important stimulus to more harmonised insurance supervision in Member States. The CRD IV will lead to a single rule book, with the removal of national options and the use of a European regulation. In addition, the role of the ESA's and their position to create binding technical standards will create more harmonisation within Europe.

141. Within these developments, the current FICOD takes an isolated position, as it leaves ample room for national interpretation. Given that financial conglomerates still constitute a large part of the financial sector within Europe and because of the fact that these institutions are often large and internationally active groups⁴⁹, there is room for increasing harmonisation.

⁴⁹ Identification of financial conglomerates, http://ec.europa.eu/internal_market/financial-conglomerates/supervision_en.htm#identification

142. More harmonisation could be achieved by strengthening the group-wide supervision of financial conglomerates within the EU and extent the scope of application of enforcement measures as discussed in the previous paragraphs.
143. Currently, there are neither harmonized rules on **reporting requirements** nor quantitative limits that need to be observed. From the JCFC questionnaire, it follows that countries have different rules on reporting risk concentrations and intra-group transactions. There may be merit in developing common reporting schemes and technical standards for reporting requirements of financial conglomerates. Within that context, there seems to be room for more harmonisation of reporting with regard to risk concentrations and intra-group requirements as indicated in Articles 7 (2), 7 (3) and 8 (2) and 8 (3) FICOD. Further, under Article 21a of FICOD1 the ESAs may develop technical standards, inter alia in relation to Articles 7 (2) and 8 (2) FICOD. However, at this juncture the ESAs have not started developing such standards. For this to be performed, the ESAs would require to undertake further analysis of the different categories of intra-group-transactions and their potential functions within financial conglomerates.
144. Finally, in line with the proposals for CRD IV (Articles 67 to 69), FICOD could introduce requirements that correspond to the nature and level of sanctioning measures that should be applied. Nevertheless the harmonization of sanctioning regimes is first a sectoral issue relevant in the frame of sectoral directives (CRD IV and Solvency II).

4. Annexes

Annex A – Summary of the answers to a JCFC questionnaire

This annex provides a short analysis of the answers given by 24 countries and one ESA.

Questions 1, 2 and 3 are related to WS1.

Q1: Are you aware of any entities, which are not covered by the definition of “regulated entity” in the meaning of Article 2 (4) FICOD? If so, which of those entities could be included in the scope of Art 5 of the FICOD?

Summary of the responses related to Q1:

Mixed Activity Holding Companies (as defined under CRD) and Mixed Activity Insurance Holding Companies (as defined under SII): most countries which responded to this specific item seem to be against the inclusion. Some countries considered the inclusion, but only for very limited purposes (namely to provide data, internal governance). One country suggested that the question to be addressed is related to the inclusion of MFHC rather than MAHC.

Pension funds, as defined by IORP Directive: most members were in favour of its inclusion, though some thoughts are needed on the consequences of this inclusion.

SPEs/SPVs as defined under Article 4(44) of CRD (2009/48/EC), or currently not captured by Article 13(26) of Solvency II (2009/138/EC): most countries wish an inclusion.

**Any type of supervised/regulated entities, which might be regulated at the national level, but are currently not covered by an EU Directive;
Any type of supervised/regulated entities, which might be regulated at national level in your country but not in another, due to different transpositions of EU directives;**

Some countries appreciate the inclusion of such entities. One country warned against the risk of jeopardizing harmonization.

Other Entities which have been mentioned: insurance intermediaries (brokers, which are legal entities), payment institutions, e-money institutions. Some countries asked for consistency between FICOD and the sectoral directives scope of application.

Q2: What are the entities, which are subject to national law and/ or sectoral directives, which are not covered at the supplementary level of the FICOD? Would you like them to be covered additionally by FICOD?

Summary of the responses related to Q2:

The main answer was pension funds. There were some variants in replies reflecting the different regulatory and legal structure for pension funds across member states. Distinctions between pension funds and mutual funds were made. The regulatory approach varies depending on whether regulation was addressed to the pension fund managers or pension fund assets themselves. In general, there was a wish to incorporate pension funds once the financial risks of the pension fund reside on the balance sheet of the conglomerate. In terms of the sectoral directives, it was pointed out that insurance ancillary activity is covered by S2 but not by the FICOD. One country also pointed out that payment institutions are regulated by 2007/64 Directive and could be considered for inclusion in the scope of FICOD.

Other suggestions for entities regulated at the national level that could be included in FICOD scope are **factoring companies and investment intermediaries.**

There was also a general comment that **sectoral directives have been transposed differently in some countries thus giving different coverage at sectoral level which has a subsequent impact at conglomerate level.** For example, **leasing companies** are regulated entities in some countries while in other they are unregulated. It may be useful to deal with this at the sectoral level.

Q3: What are the financial activities not captured under Article 2(8) of the FICOD, which could be captured and subject to the supplementary level of the FICOD?

E.g. Insurance ancillary services and/or Occupational Pension Schemes. Should any of these financial activities be included in the 40% threshold of FICOD?

Summary of responses related to Q 3:

The summaries of responses to this question can be split into 3 categories:

- which entities should be included
- which entities should fall within the financial sector
- which entities should be excluded

Entities to be included

There was broad support for the inclusion of ancillary insurance services undertakings within the financial sector definition on the basis. This did not seem to be consistent with the banking sector which does include ancillary banking services undertaking within the financial sector definition.

The inclusion of pension funds was supported by 6 respondents. Some respondents stated they would wish to include Occupational Pension Schemes as defined in IORPS Directive 2003/41/EC, however, it should be noted that there are possible variations in what was meant by pension funds across the member states and as detailed in the IORPS directive.

As detailed in the Q1 and Q2 there was support to include SPEs and SPVs and it was highlighted that the FICOD needed to tackle how to capture these entities given that the usual relationships to ensure consolidation do not always exist in these entities.

Whilst there was no majority consensus the following entities were also suggested for inclusion by various respondents:

- Mixed Activity Holding Company and Mixed Activity Insurance Holding Company.
- Investment ancillary Services undertaking
- Factoring Services
- Parabanking institutions- those engaged for example in loan activities but not subject to banking regulations (PL response)

Entities within the financial sector

There was broad agreement that in principle all financial entities should be considered as part of the 40% threshold test and should cover all the activities regulated by European Directives (CRD, S2, and AIFM). In addition one respondent added the following directives to this list: EMIR, PSD, pension funds.

One respondent remarked that whilst balance sheet figures are the basis of calculating the thresholds this may not be relevant in the cases of some the entities being discussed for inclusion in terms of the risks posed to the conglomerate. Furthermore, there was concern that the identification of a conglomerate itself may not be triggered when considering whether such entities

are to be added to the insurance or the banking sector which in turn may affect the balance of business.

Not all respondents who suggested the inclusion of new entities supported that such entities should be considered as part of the 40% financial sector threshold. There were comments to suggest a reassessment of the thresholds could be warranted.

One respondent supported a provision based on a substance over form principle where the inclusion of entities would be enabled in Art 2 (8) after some level of analysis, taking into account specificities and materiality factors (material brokers were given as an example).

Entities which should be excluded

One respondent suggested that ancillary services undertakings could be excluded from the banking sector and ancillary services undertakings need not form part of the Insurance sector.

There were further responses which explicitly stated that Insurance ancillary services undertaking should not be subject to FICOD.

A further explicit response received suggested that Occupational Pension Scheme should not form part of the 40% threshold.

Questions 4 and 5 (structured in 13 sub-questions) are related to WS2.

Q4a May an unregulated parent entity be responsible for compliance with group wide requirements?

In some countries, only regulated entities can be (for legal reasons) or are (de facto) top entities.

In countries where unregulated entities are or can be top entities, such holdings, even when they are not themselves subject to supervision, are in general a primary contact for supplementary supervision with a duty to report (or organise the reporting) to the coordinator / supervisor on risk concentration, intra group transactions, soundness of internal control and risk management framework. Such leading entity may also be responsible for reporting on capital adequacy and strategy, although enforcement is done at regulated subsidiaries.

In certain countries, the responsibility for group wide requirements lies with a regulated entity below the unregulated top entity.

Powers of supervisors on unregulated entities are limited in the majority of MSs having answered "yes" to the question. Some supervisors apply a fit and proper test on financial soundness of the unregulated top entity or on its senior management. One supervisor mentioned a controller regime where restrictions on share transfer could be imposed.

One supervisor expressed the view that it should have the power to impose group requirements on a top unregulated entity.

Q4b May a non-operating parent entity be responsible for compliance with group wide requirements?

In several instances, answers to this question referred to the answer provided in Q4a above, which suggests that there is a relevant distinction amongst top entities in a group between regulated -supposed to be operating- entities on the one hand and non operating presumably unregulated entities on the other hand.

One supervisor mentioned that the responsibility lies with the entity subject to supplemental supervision (an operating entity).

However, several countries indicated that MFHC - although non-operating (and even when they are not subject themselves to supplementary supervision) - are responsible for compliance with the (somewhat limited) Financial Conglomerate Directive requirements. One supervisor mentioned that the owner of a licensed company may be responsible for group wide governance and reporting.

Q4c.1 Does "responsible for compliance with group requirements" mean "Having power to enforce entities within the group in respect to group-wide requirements"?

Negative answers to this question generally referred to a difficulty to combine such clause with company law.

One supervisor suggested that its positive answer was given because in any case all top entities were regulated (and as such, are responsible for capital adequacy, large exposure monitoring, internal control, risk management and transparency).

One country indicated that the top entity must ensure that entities in the group provide requested data to the supervisor although another country answered that parent companies must obtain from their subsidiaries the information necessary to comply with group wide requirements and report to supervisors.

Several countries mentioned that parents should have the necessary power because either they exercise influence (not defined) or they control their subsidiaries.

In one country, credit institutions are liable to ensure that the companies they control do prudent operations (the board of directors having the power to instruct the board of the subsidiaries on that matter). Another supervisor mentioned that the parent should issue rules in the interest of the financial stability of the group and accordingly has the duty to make subsidiaries comply in term of group structure and management.

Q4c.2 Does "responsible for compliance with group requirements" mean "Having sanctionable duties (i.e. punishable if not complied with) towards the supervisor"?

One positive answer was given because all top entities are regulated in the concerned country.

On the other hand, some supervisors expressed their concern that their powers were unclear in this regard when the top entity is unregulated. One supervisor mentioned that where an unregulated parent would prevent one of its regulated subsidiaries to apply the regulation, the supervisor would in practice take action against the regulated entity itself.

Several supervisors mentioned that supervisors have some powers on unregulated entities when they fail on their duties (e.g. transmitting data, fit and proper issues) including for instance prohibition from exercising its voting right in a regulated subsidiary or ordering a regulated entity not to comply with instructions from its parent or even ordering sale of the shares in the regulated entity.

However, one country mentioned that the supervisor has the same powers towards a MFHC as under sectoral regulation, plus some abilities concerning fit and proper.

Q4c.3 Does "responsible for compliance with group requirements" mean "Having explicit powers to provide strategic direction to other entities within the group"?

On the one hand, some negative answers were given because of company law.

On the other hand, some positive answers were given because control provides the parent with the ability to give strategic guidance to the group (including through nomination of appropriate persons and organisation of internal control).

One country expressed the view that the practical ability to manage and coordinate was a prerequisite for being an acceptable responsible parent (from a supervisory point of view).

Q4c.4 Does "responsible for compliance with group requirements" mean "Give entity/ies within the group explicit duties to provide data/information to the responsible entity"?

The negative answer referred to corporate law.

Again, on the other hand some positive answers referred to the powers given by the control or the duty of directors of subsidiaries.

Several countries mentioned that their legal framework encourages / authorises the circulation of information inside a group (or at least towards the parent) in the perspective of consolidated or supplementary supervision (notably in view of calculation of capital adequacy and reporting on intragroup transactions and risk concentration).

One country stressed that transparency lies on parents since they were regulated anyway.

One supervisor mentioned that fines might be applied in case of breach. Another one stated that where a supervised top entity fails to obtain required data for an entity, book value of the own funds of such entity may be deducted from the own funds of the conglomerate.

However, one supervisor noticed that these powers were not sanctionable in its country, although another supervisor mentioned that as an exception, it has direct powers concerning information over unregulated entities (including an unregulated holding). Another supervisor mentioned that when the unregulated parent fails to provide relevant information, the obligation lies with regulated entities below.

Q4d Should powers / responsibilities of parent change when its entities belong to a different sector?

Most supervisors see no reason for a top entity having different powers or responsibilities because its subsidiaries belong to different sectors.

The parent should be responsible to define the strategy, no matter to which sector the parent or its subsidiaries belong to.

However, some supervisors suggest that, for instance, board members of a parent that owns subsidiaries in another sector should have specific knowledge in such sector additionally to their normal competence.

Finally, another supervisor noticed that if the focus of the question was not related to the power of the holding company towards its subsidiaries (a matter of company law) but to the powers of the supervisor on the holding, in his country a holding may be required to meet group requirements only in relation to specific regulated entities (powers are the same but requirements may differ).

Q5a i) Should requirements concerning governance (CRD, S2, FICOD1) be imposed on a group wide basis on a responsible parent entity?

Yes, there was full consensus on this question.

One supervisor insisted that any new requirement should follow the future Joint Forum principles.

Q5a ii) Should the Commission crisis management requirements be imposed on a group wide basis on a responsible parent entity?

Not all countries answered this question but a majority of those who expressed views were of the opinion that the parent should be imposed with crisis management requirements.

One supervisor added that (i) the parent should be responsible for preparing recovery and resolution plans for the whole group and (ii) extraordinary measures could be imposed on the parent in case of a crisis, including when the difficulties arose in another entity within the group.

The supervisors who gave a negative answer said that the question was premature since we did not know yet the outcome of the crisis management project at EU level.

Q5a iii) Should requirements concerning other topics be imposed on a group wide basis on a responsible parent entity?

Notably, following proposals were made:

- Group strategies should cover broad spectrum of prudential requirements (including capital)
- Risk exposure and capital adequacy requirements

One country noticed that requirements that apply to a group as a whole should apply to the parent; conceptually, they differ from solo requirements.

Q5b Should sanctions differ whether responsible entity is regulated or not?

The apparent lack of consensus on this question may hide the fact that supervisors have stressed one point or another in their answer. But when we look at the global picture we may identify key points of agreement.

Several supervisors noticed that the current FICOD provides no effective sanction regime when the top entity is not regulated although regulated entities might be sanctioned in case of breach. The effectiveness of supervision may be hampered when sanctions concern unregulated entities and therefore sanctions are often directed to regulated entities below to ensure enforcement.

One supervisor noted that there is also an issue when the financial group belongs to an unregulated non financial company. Supervisors should have the capacity to require the relevant information to assess the risks posed by the non financial activities of the conglomerate to the financial sector

We need to make the distinction between responsibilities of an (unregulated) top entity of a group and potential sectoral responsibilities when the top entity is regulated. Enforcement measures and sanctions for the role of parent should not depend on the fact that the parent is regulated or not. In principle, at least conceptually, sanctions concerning breaches related to supplementary supervision should be the same for any financial entity designated as top entity of a group; they may differ depending on the risk profile of the group but not on the legal situation of the top entity.

However, in principle, sanctions should be directed only to regulated entities. It seems that supervisors may agree to consider strengthening the duties of the (currently) unregulated parent by applying to it some form of common regulation at EU level. This would improve the level playing field.

Q5c Should sanctions differ whether responsible entity is operating or not?

With the same approach as in Q5b above, but this time with an even clearer consensus, supervisors think that sanctions should not differ depending on the operating or non operating situation of the top entity.

One supervisor expressed the view that if the non operating top entity was influential, clearly the range of sanctions should be the same as if it had been

operating. Although, if the top entity is not influential, sanctions might be more effective at operational entity level.

Another country suggested that the non operating holding supervisor should have the capacity to require relevant information and to make inspections to evaluate the impact of non financial entities within the group on financial activities. It should also have the right to impose the establishment of an intermediate holding when deemed relevant.

Finally, another supervisor mentioned that any responsible parent should be regulated.

Q5d Should sanctions differ whether entities are in different activity as parent?

There seems to be nearly a consensus: entities in a group should follow their sectoral rules and may be sanctioned in case of infringements of these sectoral rules, disregarding the sectoral regime of their parent (if any).

However, one supervisor commented a positive answer to keep some flexibility.

Another country explained its positive answer with the following reasons: Since entities can be in different jurisdictions, sanctions can also be different. On the other hand, one supervisor stressed the need to have a level playing field with CRD and S2 due to the possibility of having different sanctions or incentives depending on the directive applied. This would increase arbitrage opportunities.

Finally, another (integrated) supervisor explained that sectoral legislation being different, reference of measurement for breaches could be different. But this issue was accommodated by its sanctioning policy being valid for all financial sectors.

Annex B – Draft Impact Assessment

Part 1: Scope

1. Introduction

This annex contains the high level Impact Assessment (IA) of the policy proposals discussed in this paper.

2. Problem definition

The purpose of the FICOD is to supplement the sectoral Directives by ensuring that the risks that may arise as a consequence of the cross-sectoral character of the group are appropriately identified and managed.

At present, there may be a range of financial activities that combined with certain group structures, and with non-regulated entities, could undermine the supervisory identification of financial risks of the group when applying the sectoral rules only. The current regulatory framework may also provide an incentive to concentrate some financial activities in certain entities or parts of the group in order to arbitrage capital requirements provisions, and so may blur the identification of some financial risks.

There are three areas that have been identified as particularly important, namely:

- 1) IORPs
- 2) SPEs/SPVs
- 3) Non operating holding companies.

We briefly discuss the relevant problems for each of these areas:

IORPs

Depending on the specific characteristics of the legislation in Member States and on the features of occupational pension schemes IORPs may or may not pose a material risk for financial groups.

IORPs' risks can be taken by the IORP itself, by the beneficiaries of the pensions, or by the group the IORP belongs to. Hence, the inclusion of IORPs in the scope of group-wide supervision under FICOD seems relevant if the financial risks ultimately lay on the balance sheet of the conglomerate.

SPEs/SPVs

One of the lessons learnt from the recent crisis has been the need to better understand and take account of risks posed by special purpose entities/vehicles to financial groups. Such vehicles can and have been used to reduce capital requirements of financial groups resulting in financial stability problems.

Non operating holding companies

When a group is not headed by a bank or an insurance company but by a company active in a different sector, competent authorities may be unable to supervise the entire group. This may result in financial stability concerns if a group has an incentive to structure itself by regulated and unregulated entities, in a way that avoids being identified as a financial conglomerate, potentially resulting in double gearing and in the avoidance of supervisory requirements.

3. Objectives

The overarching objective of the issues discussed in this paper is to ensure that an appropriate capital requirement can be calculated based on the groups' risks and that supervisors have the necessary tools to mitigate/take measures on these risks.

More specific objectives are to make sure that the treatment of conglomerates is consistent across Member States, reinforces prudential regulation of conglomerates where gaps remain and ensure that risks are appropriately taken into account when they are spread within a group.

4. Policy options

The perimeter of supervision can be tackled from two perspectives. The range of "regulated entities" [in the sense of Article 2 (4) FICOD] could be increased. Alternatively, the definition of "financial sector" [according to Article 2 (8) FICOD], which is relevant for the identification of a financial conglomerate, could be extended. Both ways are possible options to include IORPs under the scope of FICOD, as long as national specificities are taken into account. Additionally, it is proposed to include ancillary services undertakings, as defined in Article 1bis (23) of the draft implementing measures of Solvency II, in the definition of financial sector in Article 2 (8) FICOD, within the insurance sector. In order to capture all relevant financial activities of a financial conglomerate, all special purpose vehicles/entities, including those not defined in Article 4 (44) CRD and the

provisional Article 4 (45) CRR IV and not currently captured by Article 13 (26) Solvency II, should be included in the definition of financial sector according to Article 2 (8) FICOD. It is proposed that MAHC and MAIHC should not be included, neither in the scope of application nor in the definition of the financial sector, as this would potentially stretch the responsibilities of supervisors too far. However, in case a financial conglomerate can be identified at a subgroup level below an MAHC/MAIHC, the MAHC and MAIHC may be subject to particular requirements, such as ad-hoc reporting obligation to the supervisor.

5. The likely impacts

5.1 IORPs Costs to supervisors and compliance costs for firms

If IORPs are brought into the scope of FICOD, national supervisors in a number of Member States will incur additional costs on account that they will need to supervise more conglomerates, and/or to supervise larger conglomerates.

Conglomerates will also incur costs to make sure that their exposures to IORPs are properly accounted when they calculate their capital resource requirements.

The scale of these for compliance costs is uncertain at the moment given the lack of available data however they would depend on the number of IORPs present in each Member State and the scale of changes required by each conglomerate. Similar to some national supervisors, the costs will vary widely on the basis of how many IORPs will be brought in scope of the FICOD.

Capital costs

Given the nature of IORPs it is unlikely that conglomerates may become compliant with FICOD by reducing their assets. Therefore conglomerates that currently do not qualify as such but that will qualify should IORPs be included in the definition as well as existing conglomerates that do not currently include IORPs in their capital calculations will incur costs to raise additional capital.

Again the size of such costs will be driven by the number of IORPs that will be brought in scope, but they could be substantial in some Member States.

Indirect costs

We have identified two different types of indirect costs that are likely to materialise should IORPs be included in the scope of FICOD.

First, there could be a reduction in the supply of pension schemes if it proves particularly costly to comply with the new provisions. This could clearly have

negative implications for employees that will have reduced access to such schemes which are, generally, particularly advantageous for them. This is likely to be a particular problem for 'defined benefits' schemes.

Second, there could be macroeconomic impacts in those Member States where a significant amount of capital will be held by conglomerates rather than being deployed in productive activities in the rest of the economy.

Benefits

The benefits of bringing IORPs within the scope of FICOD will be to reduce the possibility that risks embedded in IORPs are not properly taken into account in capital resources.

These benefits will be larger if IORPs are in the conglomerate's balance sheet but are currently not taken into account for capital requirements. The benefits will be substantially lower if the IORPs are not on the balance sheet of the conglomerate or if the risk ultimately falls on the beneficiaries of the pension fund. However, even in these cases IORPs may pose operational and reputational risks that may fall on the conglomerate in any case.

5.2 Non operating holding companies

Tool 1 – Supervisors could be empowered to require the creation of an **intermediate financial holding** which holds all the entities carrying out financial activities subject to supplementary supervision (or, at least, all the regulated entities).

Advantages: this tool would ease the supervisory tasks, because it provides a simple and clear structure, with direct links among the entities which are under supplementary supervision. This is also consistent with **Joint Forum Principle 11** which requires that the structure of the financial conglomerate has a transparent organisational and managerial structure; in addition, the implementation criteria of this principle state that "*supervisors should seek to ensure that the structure of the financial conglomerate does not impede effective supervision and seek restructuring under appropriate circumstances*".

Disadvantages: some Member States could have legal impediments to ask for such a restructuring due to their domestic **company law** or, even, their national constitution, as enterprises usually have the fundamental freedom to choose their own organisation and structure. In particular, the power envisaged in this option is very relevant when we consider the fact that it relates to the grouping of entities which can be scattered among an economic group, even if they are not regulated entities. A possible limitation of such tool could be to limit this power

only to the grouping of the regulated entity under the same umbrella, which is a power that some Member States already have and exercise in sectoral supervision. However, such limitation enables companies to circumvent regulation: if all the unregulated entities carrying out financial activities were dependent (for example, from the top unregulated entity or the industrial part of the group), they would not be captured in the sectoral consolidation perimeter nor captured in the supplementary supervision. With regard to the **MFHC**, this option may still have some value, even if supervisory powers on MFHC are broader than the ones the supervisors currently have or will have according to the suggestions made in Part 2. In fact, whenever there are very complex structures, the creation of an intermediate financial holding enables supervisors to group all financial activities and “insulate” them from the industrial part of the group from a formal point of view.

Tool 2 requires the designation of one “**point of entry**” at the **(unregulated or regulated) top entity** of the entire industrial group, in place of a formal ‘common chapeau’ of the financial entities within the group.

Advantages: it is easy to implement; there should be no problems with company law for supervisors because no restructuring is required.

Disadvantages: there are some doubts on the possibility to define responsibilities and sanctions on a “natural person”. For example, in case of sanctions there should be a rule which enables to punish also the entity to which the natural person belongs to in order to avoid that the administrative sanctions find a limit in the wealth of the natural person.

Tool 3 consists in designating a **regulated entity as a point of entry**, such that the entity responsible for performing the specific duties towards the supervisors is the legal addressee of supplementary supervision, though it might not be at the top of the financial conglomerate.

Advantages: this solution is consistent with the sectoral rules which identify only the regulated entities as being responsible for supervisory purposes. It is also easy to implement. There should be fewer problems on account of company law, because no restructuring is directly requested (though the supervisors may ask for structures which do not impede the supervision).

Disadvantages: Given that the “designated” entity might be below the (unregulated) top entity of the financial conglomerate, this top entity directing the entire group might not respond directly to the supervisory request. Therefore, if a

supervisory action is needed, it cannot be addressed to the real responsible (unregulated) top entity of the group, but it can reach the top of the group only indirectly via the regulated subsidiary.

6. Comparison of options

At this juncture, based on the limited amount of evidence currently available, it is particularly difficult to reach a clear verdict on which specific options should be preferred in many instances. Nevertheless, the ESAs at this juncture propose:

- Ancillary insurance services undertakings should be included in the definition of financial sector, as their activities are clearly relevant for the risks that FICOD is trying to mitigate.
- SPEs/SPVs should be included in the definition of financial sector, as they can and have been used to reduce capital requirements by eluding sectoral rules and the FICOD.

However, instances where a clear favourite option could not be determined on the basis of the information that is currently available are:

- whether or not to include IORPs in the scope of the amended FICOD given the differences in legislation across Member States and the differences in risk that such entities pose to financial conglomerates depending on their specific features;
- the specific treatment of non operating holding companies, and more specifically whether or not to designate an 'intermediate financial holding', a regulated entity or an unregulated entity as the point of entry for the supervision of the conglomerate.

Part 2: Governance and ultimate responsible entity

Recommendation 3: Define and identify an ultimate responsible entity for each financial conglomerate according to specific criteria.

Advantages:

1. Enhancement of top level supervision consistently with FICOD1
2. Enhanced consistency between sectoral supervision on FHC and IHC and MFHC
3. No risk of reducing sectoral supervisory standards while implementing paragraphs 1 of new articles 72a and 213 inserted respectively in CRD and S2 by FICOD 1
4. Enhanced harmonisation within Member States implementing legislation on top level supervision with respect to financial conglomerates.
5. Identification of ultimate responsible entity in NON-Financial Conglomerates: see advantages discussed in part 1 when ultimate responsible entity is identified within a complex group which cannot be identified as a financial conglomerate according to the current supplementary framework (See also Annex D).

Disadvantages:

1. Difficult to provide a definition for ultimate responsible Entity which would be suitable for all Member States national implementation of "control" and "dominant influence" concepts.
2. May be difficult for the Coordinator and the Relevant Competent Authorities to agree to the designated ultimate responsible entity;
3. Identification in NON-Financial Conglomerate: See disadvantages discussed in part 1 when ultimate responsible Entity is identified within complex groups which cannot be identified as financial conglomerates according to the current supplementary framework (See also Annex D).

Recommendation 4: Explicitly require ultimate responsible entities to take up a coordinating and directing role over the entities included in the conglomerate. In particular:

- **define internal governance duties/responsibilities for ultimate responsible entities,**
- **set requirements related to such duties/responsibilities.**

In addition, possibly enhance:

a. EU capital management requirements

FICOD2 might want to specify that the responsibility on overall group capital policy might possibly entail that:

(i) **the ultimate responsible entity should not cause regulated entities within the Financial Conglomerate to breach their respective sub-consolidated and solo capital requirements** whilst not absolving their individual responsibility for capital management;

(ii) **additional supervisory measures are made available in relation to the regulated entities if breaches occur at the group level and vice versa** in relation to the top entity if breaches occur at solo level;

(iii) both solutions (i) and (ii) above are provided to supervisors.

b. EU reporting requirements

Include in FICOD2:

(i) **provisions which detail the ultimate responsible entity's duties on reporting these phenomena, which from a top level supervision point of view should enable supervisors to develop an assessment not only on the level of outstanding exposures, but also on how financial resources are allocated throughout the financial conglomerate** (e.g. from some entities/sectors towards others; from one country to another; from regulated to unregulated entities; from controlled toward participated entities);

(ii) **provisions which better specify the scope of Article 14 of the FICOD/FICOD1**. This article provides Member States with the facility to remove obstacles to information sharing among the entities belonging to a financial conglomerate, and therefore, is the provision to refer to when requesting that risk concentration and intra-group transactions are reported by the ultimate responsible entity with respect to the whole group.

c. EU governance requirements

Include in FICOD 2 provisions substantially aligned with the recent ESA Guidelines on internal governance⁵⁰ and the on-going works related to the implementation of Solvency II.

Advantages:

1. Ensure that group-wide supervisors may possibly refer to a unique addressee and reduce the number of interventions needed in case of group-wide concerns.
2. Strengthen supervisors' intervention ability over the whole group through the ultimate responsible entity.
3. Making it easier that the whole set of entities in a conglomerate feels responsible for group-wide requirements.
4. Further increase consistency between sectoral Directives and FICOD/FICOD1 with respect to prudential requirements including those extended to holding companies.
5. Align EU framework with new JF Principles concerning the "head of financial conglomerates".

Disadvantages:

1. Difficulties in finding harmonised solutions for ensuring consistency between prudential requirements and rights and duties provided for in each and every Member States' national corporate laws;
2. Difficulties in defining requirements having the same level of enforceability within all Member States.
3. Difficulties in defining a stronger role for ultimate responsible entity in every situation including emergency /crisis.

⁵⁰ [http://eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2011/EBA-BS-2011-116-final-\(EBA-Guidelines-on-Internal-Governance\)-\(2\)_1.pdf](http://eba.europa.eu/cebs/media/Publications/Standards%20and%20Guidelines/2011/EBA-BS-2011-116-final-(EBA-Guidelines-on-Internal-Governance)-(2)_1.pdf) EBA Guidelines on Internal Governance, September 2011.

Part 3: Sanctions

Observation	Associated risks	Possible way forward	Objective
1. Sectoral-based supervision	Insufficient attention for the specific risks that derive from cross-sectoral nature of a financial conglomerate.	Strengthen group-wide view and focus on supplementary risks.	Comprehensive group-wide supervision (Joint Forum Principle 1)
	Enforcement measures may not be fully available towards the entity that is ultimately responsible for the group as a whole.	Effective enforcement regime that combines enforcement instruments at ultimate responsible group level with enforcement powers at sectoral level towards underlying entities.	Range of appropriate supervisory activities and utilise supervisory to towards the financial conglomerate or its constituent entities to compel corrective actions and enforce compliance (Joint Forum Principles 8 and 9)
	Sectoral differences and unlevel playing field	Maintain consistent approach in sanctioning regime between SII and CRD IV (issue out of scope of FICOD)	Sectoral consistency
2. Differences in national implementation	May undermine single market and single rule book	Reduce room for national discretion.	Harmonisation of regulation and level playing field

Annex C – Definitions

Financial Holding Company

Article 4 (63) CRR: “means a financial institution, the subsidiaries of which are either exclusively or mainly institutions or financial institutions, at least one of such subsidiaries being an institution, and which is not a mixed financial holding company within the meaning of Article 2(15) of Directive 2002/87/EC”.

Article 26 (amendments to Art 7(3) of Directive 93/6/CEE): “shall mean a financial institution, the subsidiary undertakings of which are either exclusively or mainly investment firms or other financial institutions, at least one of which is an investment firm, and which is not a mixed financial holding company within the meaning of Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate”.

Insurance Holding Company

Article 212 (f) Solvency II: “means a parent undertaking which is not a mixed financial holding company within the meaning of Directive 2002/87/EC and the main business of which is to acquire and hold participations in subsidiary undertakings, where those subsidiary undertakings are exclusively or mainly insurance or reinsurance undertakings, or third-country insurance or reinsurance undertakings, at least one of such subsidiary undertakings being an insurance or reinsurance undertaking”.

Mixed Financial Holding Company

Article 4 (85) CRR: “shall mean a parent undertaking, other than a regulated entity, which together with its subsidiaries, at least one of which is a regulated entity which has its head office in the Community, and other entities, constitutes a financial conglomerate”.

Article 2 (15) FICOD: “shall mean a parent undertaking, other than a regulated entity, which together with its subsidiaries, at least one of which is a regulated entity which has its head office in the Community, and other entities, constitutes a financial conglomerate”.

Mixed Activity Holding Company

Article 4 (71) CRR: "means a parent undertaking, other than a financial holding company or an institution or a mixed financial holding company, the subsidiaries of which include at least one institution".

Article 26 (amendments to Article 7(3) of 93/6/CEE) "shall mean a parent undertaking, other than a financial holding company or an investment firm or a mixed financial holding company within the meaning of Directive 2002/87/EC, the subsidiaries of which include at least one investment firm."

Mixed Activity Insurance Holding Company

Article 212 (g) Solvency II: "shall mean a parent undertaking, other than an insurance undertaking, a third-country insurance undertaking, a reinsurance undertaking, a third-country reinsurance undertaking, an insurance holding company or a mixed financial holding company within the meaning of Directive 2002/87/EC, which includes at least one insurance or reinsurance undertaking among its subsidiary undertakings".

Ancillary services undertaking

Article 4 (2a) CRD IV: "means an undertaking the principal activity of which consists in owning or managing property, managing data-processing services, or any other similar activity which is ancillary to the principal activity of one or more credit institutions

Operating entity

Article 22 (20) CRR: "means an entity established with the purpose of earning a profit in its own right"

Special Purpose Vehicle (SPV)

Article 11 (26) Solvency II: "means any undertaking, whether incorporated or not, other than an existing insurance or reinsurance undertaking, which assumes risks

from insurance or reinsurance undertakings and which fully funds its exposure to such risks through the proceeds of a debt issuance or any other financing mechanism where the repayment rights of the providers of such debt or financing mechanism are subordinated to the reinsurance obligations of such an undertaking.”

Securitisation special purpose entity (SSPE)

Article 4 (45) CRR IV: “Means a corporation trust or other entity, other than an institution, organised for carrying on a securitisation or securitisations, the activities of which are limited to those appropriate to accomplishing that objective, the structure of which is intended to isolate the obligations of the SSPE from those of the originator institution, and the holders of the beneficial interests in which have the right to pledge or exchange those interests without restriction.”

Annex D – Consolidation of SPEs/SPVs

Control

A regulated entity may control another entity even in the absence of ownership stake in it. In determining whether a control relationship exists, reference is made to the sectoral definition of control, which is usually derived from the accounting definition. The relevant indicators of control for accounting purposes, in the context of structured finance vehicles may include SIC 12 (International accounting standards), for instance. Concepts that are relevant in assessing accounting control in the context of structured finance vehicles (e.g. 'auto-pilot execution' of actions in accordance with a prescribed and documented procedure) focus primarily on the retention of risks and benefits from the sponsor firm. In addition, consideration should also be given as to whether a single risk exists between the regulated entity and the SPE.

Economic interconnectedness

Economic interconnectedness occurs where funding or repayment difficulties experienced by one entity (e.g. the SPE) result in another entity (e.g. the regulated entity) being likely to encounter similar difficulties.

Contagion

Contagion risk exists where difficulties in one entity can spread to another entity. In considering whether or not to bring a SPE within the scope of a financial conglomerate, at least the following channels of contagion should be considered, as set out in the Joint Forum Report on SPEs:

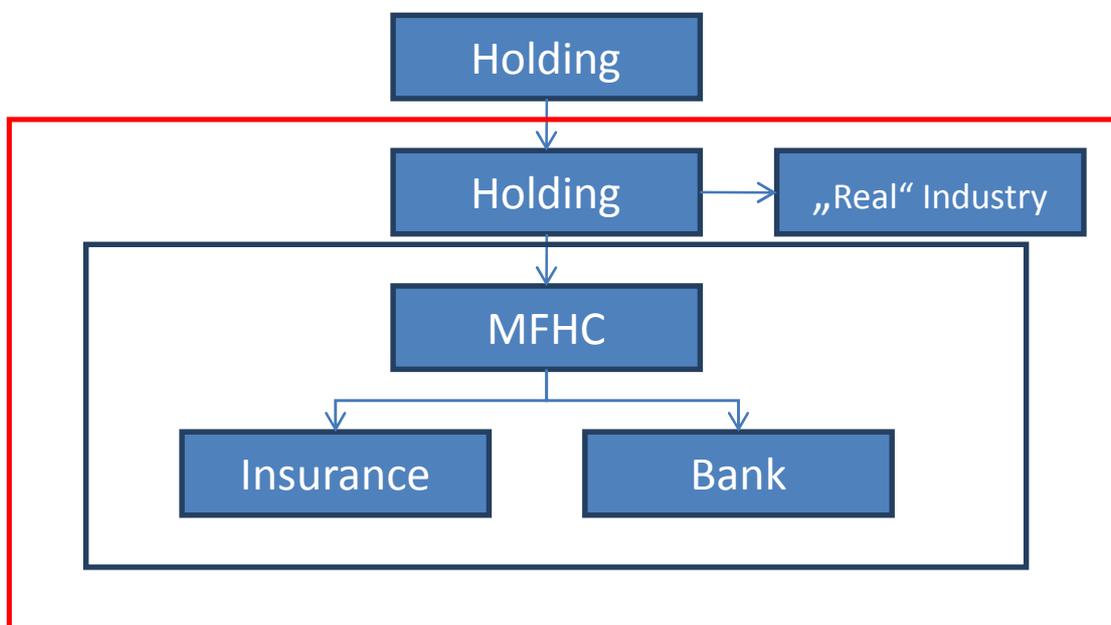
- Reputational risk: The entity does not wish its own perceived credit quality to be blemished by the underperformance or default of an affiliated or sponsored SPE.
- Signalling effect: The poor performance of collateral in an SPE is attracting a high degree of attention, and assumptions are being made that the quality of the firm's own balance sheet can be judged on a similar basis.
- Franchise risk: The entity does not wish to upset investors in an affiliated SPE as the entity has other relationships with these investors, for instance as holders of the unsecured debt of the firm itself.

- Liquidity and funding risk: The aggregate of the three risks outlined above could be that the poor performance of an affiliated SPE causes a firm's access to the capital markets for its own liquidity and funding purposes to be endangered. In such a case, this risk essentially increases the firm's willingness to absolve third-party investors in an SPE of the credit risk they assumed to avoid endangering its own access to the capital markets.
- Equity risk: The entity might hold a large equity tranche in a vehicle (for example, a structured investment vehicle (SIV) that is at risk). If the firm does not step in and support the vehicle after it has hit certain triggers (for instance, market value triggers) the resulting wind-down of *the SPE and sale of the assets at depressed valuations is likely to erode their equity in the SPE to a greater extent than the firm stepping in and either affecting an orderly wind-down of the vehicle or taking the assets back on balance sheet.*
- Mark-to-market risk: *The forced sale of assets from an affiliated SPE could depress the value of related assets that the firm actually holds on balance sheet, and the firm wants to prevent a large negative mark-to-market impact on its own balance sheet.*
- Little risk transfer: *If the firm determines that there was little economic risk transfer in the first place (for instance, the trenching is such that only catastrophic risk that is unlikely to crystallize, has really been transferred), it may be more willing to step in and voluntarily support an affiliated SPE.*

The circumstances described above may become evident during or after a stress event. The aim to provide support in stress circumstances could give rise to the need to consolidate a previously unconsolidated SPE for accounting purposes. Given that regulation is forward looking (as opposed to accounting which is more a point in time), it may well be appropriate to consolidate a SPE even before actual support has been provided to it by the regulated entity. Competent authorities should consider whether consolidation should be full or proportional consolidation dependent on the level of risk perceived. Further, financial conglomerates should have the capability to aggregate, assess and report all their SPE exposures in conjunction with all other firm-wide risks.

Annex E – Types of Structures of complex financial conglomerates

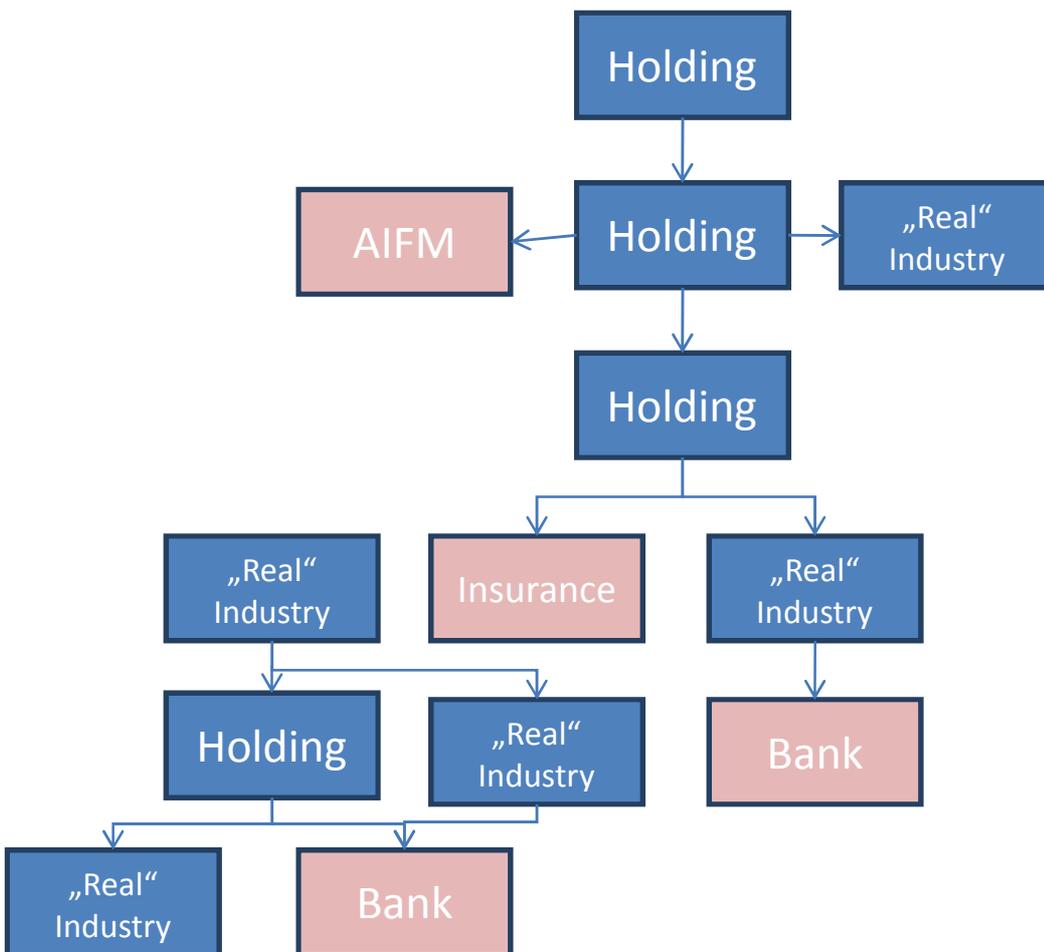
The following example illustrates that there are some group structures that make it very difficult to identify a financial conglomerate: In some cases a subgroup within a large complex group (hereafter LCG) qualifies as a financial conglomerate. But after calculating the threshold for the entire group (including the “real” industry) this group does not fulfil the FICOD’s 40%-threshold and, therefore, the whole group will not be subject to supplementary supervision.



This situation may also be a way of avoiding supplementary supervision. By setting up a chain of holding companies with subsidiaries of “real” industry the 40%-threshold will not be fulfilled after a certain point.

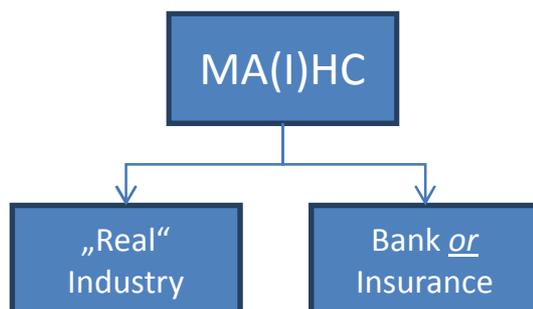
Currently, the supervisor is only allowed to address the regulated entity (e.g. in order to get information). The regulated entity has to cooperate with its parent entity (and is responsible for the delivered information to the supervisor) but has (under company law) no powers to get necessary information. Therefore **the possibility to address supervisory issues concerning information and sanctions to holding companies should be strengthened.**

In addition, there might be structures which are even more complex. In these cases industrial groups may have many different regulated entities which are not held by one parent entity but are spread over the group.



In this case, it is almost impossible for supervisors to identify the holding company which may qualify as MAHC or MAIHC. Further, supervisors might not be able to supervise the group on a group-wide level to avoid double gearing; but the regulated entities of the banking and insurance sector are all supervised on a solo level. The potential negative effects (arising from intra-group transactions or risk concentrations) are scarcely visible. This may lead to spill-over effects (either from the industrial part to the financial part or vice versa). Consequently, supplementary supervision on a group wide-level would help (if this group does not qualify as a financial conglomerate according to Article 3 FICOD). Thus, introducing a responsible entity within the group as an addressee for supervisory actions would lead to more clarity from a supervisory point of view.

Another challenge for supervisors might be a group structure like the following:



The parent entity will be identified as MAHC or MAIHC (depending on the supervised type of subsidiary). However, the supervisor can only address the regulated entity which is a bank or an insurance company. In that case there may be the possibility for double gearing or regulatory arbitrage via non-supervised entities. Since the aim of group wide supervision (proposed by CRD, Solvency II and FICOD) is predominantly to avoid double gearing, regulatory arbitrage and contingency effects, the parent holding company needs to be assessed. Thus, this parent holding company should be made addressee of supervisory sanctions and the point of contact for the supervisor to get information. The parent entity should be responsible for group-wide risk management and the implementation of corresponding processes.

OBSERVATION: Types of complex financial groups

Financial conglomerates are by definition mainly active in the financial sector [Article 2 (14) in combination with Article 3 FICOD]. However, there are some large complex groups which also provide financial services to clients and markets.

Although those groups do not qualify as a financial conglomerate, because of the non financial part of their activity, they may bear some risks, such as:

- The group relies heavily on financial earnings.
- Large exposure(s) with one investment/counterpart/region.
- Large intragroup exposures/transactions.
- Negative spill-over effects to the industrial part of the group.

Consequently, supervisors should be able to monitor the group, with a focus on the financial part of it.

Annex F – Current EU requirements and the new Joint Forum Principles

1. EU requirements

a) Current EU capital management requirements

Article 6 (2) subparagraph 1 FICOD provides that

(i) regulated entities ensure that own funds available “at the level of the financial conglomerate” are at least equal to the capital adequacy requirements as calculated according to Annex 1 of the Directive and that

(ii) capital adequacy policies are set “at the level of the financial conglomerate”.

This is the highest level of the group, i.e. headed either by a MFHC or by a regulated parent entity.

In addition, Article 6 (2) FICOD clarifies that the obligation to comply with capital requirements at the highest level possible is applied to each of the regulated entities within the financial conglomerate.

However, it is possible that the whole set of regulated entities may not be able to control or manage resources or risks at that level. In most circumstances, capital resources held in the group for the purposes of compliance with group/consolidated supervision will be generated and controlled by the ultimate parent undertaking. This parent undertaking could be either a regulated entity or an unregulated financial holding company.

b) Current EU reporting requirements

The existing FICOD/FICOD1, the CRD, the IGC and Solvency II impose reporting requirements regarding significant risk concentrations and significant intra-group transactions. While the requirements in these Directives do not substantially differ regarding the determination of the responsible reporting entity, they differ on the definition of significant risk concentrations and significant intra-group transactions.

In these Directives the following entities are responsible for reporting:

- in FICOD1, reporting is required either from regulated entities or MFHC. Hence, reporting requirements placed on the top entity are not excluded.

- Solvency II states that the top entity of the group should be responsible for reporting the intra-group transactions. Hence the responsibility could be placed also on the top insurance holding companies.
- the CRD puts the responsibility of monitoring and reporting large exposures on credit institutions. However, when credit institutions are controlled by a financial holding company, under specific circumstances, the CRD provides that compliance with large exposures rules and related reporting requirements is ensured at the consolidated level on the basis of the financial situation of the financial holding company (see Article 71).

c) Current EU governance requirements

In FICOD/FICOD1, governance requirements relate to (i) risk management and internal control (Article 9) and (ii) fit and proper criteria for MFHC (Article 13). However, the restored availability of sectoral powers over such MFHC provided by FICOD1 amendments to sectoral Directives and makes it clear that, in order to avoid an overlap between these powers and to ensure the effectiveness of top-level supervision, supervisors should be able to **apply a particular provision only once**.

Taking into consideration Recital 14 FICOD1, it is evident that the governance requirements are the most likely to be eligible for the waiver, specifically because control/dominant influence/steering relationships are mostly the same irrespective to the exercised activities.

2. Requirements according to the new Joint Forum Principles

The new Joint Forum Principles discuss the following implications for the ultimate responsible entity:

a) Coordinating and directing role for the top entity of the financial conglomerate

Taking into account that in the Joint Forum work the role of the parent undertakings is mostly mentioned in the context of governance requirements, the principle implying that the top entity of the financial conglomerate has a coordinating and directing role within the group is Joint Forum **Principle 13** ("Responsibility of the board of the top entity of the financial conglomerate") which states explicitly that:

“Supervisors should require that the board of the top entity of the financial conglomerate appropriately defines the strategy and risk appetite of the financial conglomerate, and ensures this strategy is implemented and executed in the various entities, both regulated and unregulated.

This requirement is to be viewed in the context of corporate governance where the coordinating and directing role of the top entity is not an issue of company law rather a question of facilitating group supervision.

Through appropriate governance arrangements which will ensure that the legal or regulatory provisions or prudential rules of regulated subsidiaries will be known and taken into account by the ultimate responsible entity, the role of this entity within the financial conglomerates serves the purposes of prudential supervision and cannot be used to impose policies on subsidiaries that would run against the purposes of solo supervision, nor against the interests of the subsidiaries themselves or their own stakeholders.

From a corporate governance perspective, the coordinating role of the top entity of a conglomerate is functional to the achievement of another important objective: namely monitoring the activities of unregulated entities within a supervised group without having to develop supervisory regimes for all such entities or operations.

b) Further requirements on the top entity of the financial conglomerate

The principle directly derived from the said “directing and coordinating role of the top entity of the financial conglomerate” is Joint Forum **Principle 11** (“Watching over the structure of the financial conglomerate”), which implies that the financial conglomerate should have:

- a transparent organisational and managerial structure, which is consistent with its overall strategy and risk profile and
- is well understood by the board and senior management of the top entity company.

The implementation criteria of High-level Principle 11 explicitly state:

“11(c) Supervisors should seek to ensure that the board and senior management of the top entity of the financial conglomerate are capable of describing and understanding the purpose, structure, strategy, material operations, and material risks of the financial conglomerate, including

those of unregulated entities that are part of the financial conglomerate structure."

"11(e) Where the financial conglomerate is part of a wider group, supervisors should require that the board and senior management of the top entity of the financial conglomerate have governance arrangements that enable material risks stemming from the wider group structure to be identified and appropriately assessed by relevant supervisory authorities."

Also the Joint Forum **Principle 12ii** (fit & proper precondition) read together with its implementation criteria could be considered as a precondition for the coordinating role of the top entity of the conglomerates. It states that:

"supervisors should seek to ensure that the board members, the senior management and key persons in control functions in the various entities in a financial conglomerate possess integrity, competence, experience and qualifications to fulfil their role and exercise sound objective judgment".

The term "various entities in a financial conglomerate" includes the top entity of the financial conglomerate, since the implementation criteria for this principle specifies that:

"supervisors require that the members of the boards of the top entity of the financial conglomerate and of its significant subsidiaries act independently of parties and interests external to the wider group";

and that:

"the board of the top entity of the financial conglomerate include a number of members acting independently of the wider group (including owners, board members, executives, and staff of the wider group)."

c) Principles and implementation criteria giving content to the coordinating and directing role of the head

Explicit tasks to the head of the financial conglomerate are directly mentioned in:

- implementation criterion 14 b requesting that *the head of the financial conglomerate has the ultimate oversight over the remuneration policy ;*
- implementation criterion 15 c requesting that *the financial conglomerate's capital management policies include a requirement for the board of directors of the head of the financial conglomerate to review*

and approve the capital management plan at least annually, or more frequently if conditions warrant;

- *high-level principle 20 requiring the head of the financial conglomerate to adequately and consistently identify, measure, monitor, and manage its liquidity risks and the liquidity risks of the financial conglomerate ;*
- *implementation criteria 20 a requiring that the head of the financial conglomerate must develop and maintain liquidity management processes and funding programs that are consistent with the complexity, risk profile, and scope of operations of the financial conglomerate;*
- *implementation criterion 21 e for which the board of the head of the financial conglomerate has overall responsibility for the financial conglomerate's group-wide risk management and internal control mechanism;*
- *implementation criterion 23 where a key staff, senior management and the board of the head of the financial conglomerate are requested to be aware of and understand the financial conglomerate's risk tolerance and risk appetite.*

Other tasks for the head of the conglomerate might be indirectly derived from the combination of High-level Principle 13 and all principles and implementation criteria mentioning requirement that must be applied on a financial conglomerate-wide basis (called "group-wide" basis in the JF consultative document).

Annex G – Group requirements

	Solvency II	CRD IV*	FICOD 1
Capital	<u>Articles 218 to 243</u> : Group Solvency requirement at the level of ultimate parent (which includes regulated insurance companies, insurance holding companies and mixed financial holding companies).	<u>Article 10 CRR and Articles 122 to 130 CRD</u> : Capital requirement at consolidated level (which includes financial holding companies and mixed financial holding companies).	<u>Article 6</u> : Capital requirement at the level of the mixed financial holding company.
Risk concentration	<u>Article 244</u> : At least annually reporting of significant risk concentrations at the level of the group. To be further specified in implementing measures.	<u>Articles 376 to 392 CRR</u> At least twice a year reporting of risk concentrations under the large exposures regime. Requirements include quantitative limits.	<u>Article 7</u> : At least annually, reporting of significant risk concentrations. No quantitative limits (suggested threshold of 5%).
Intra-group transactions	<u>Article 245</u> : At least annually reporting of significant intra-group transactions within the group. To be further specified in implementing measures.	Falls under the scope of consolidated supervision and large exposures regime.	<u>Article 8</u> : At least annually, reporting of significant risk concentrations. No quantitative limits (suggested threshold of 5%).
Governance	<u>Article 246</u> : Requirements on governance, including risk management, internal control and	<u>Articles 86 to 91</u> : Requirements on governance, management and remuneration at the	<u>Article 9</u> : Adequate risk management processes and internal control mechanisms at the

	reporting procedures at the level of the group (which includes regulated insurance companies, insurance holding companies and mixed financial holding companies).	level of the group.	level of the conglomerate.
--	---	---------------------	----------------------------

* Based on 20 July 2011 draft proposal by the European Commission