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FCD REVIEW ROADMAP: WORK TO BE UNDERTAKEN GOING FORWARD

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FCD Review roadmap

1. This paper was discussed by members of the European Financial Conglomerates Committee on 11 April 2008.

Background and Introduction

2. The Financial Conglomerates Directive (“the FCD”) had a transposition deadline of 11 August 2004, and the supervisory requirements arising from the FCD entered into force on 1 January 2005. Article 31 of the FCD provides that “the Commission shall submit to the Financial Conglomerates Committee...a report on Member State’s practices, and if necessary on the need for further harmonisation” by 11 August 2007.
3. At its meeting on 27 March 2006, the EFCC discussed when certain elements of the Article 31 review should be brought forward. The general feeling of EFCC members was that it would be better to wait until the Directive had been in force longer, hence allowing supervisors and other authorities to gain more practical experience with the application of the FCD.
4. The Commission Services intend to perform a review of the FCD, to address the issues set out in Article 31 and, consistent with the Better Regulation agenda, to consider whether the FCD has achieved its objectives.
5. The review will be guided by the objectives of the FCD, which establish the supplementary supervision of regulated entities that form part of a conglomerate. The Directive provides such supplementary supervision by focusing on potential risks of contagion, concentration and complexity.
6. This paper presents a roadmap for the FCD review. First, it sets out the scope of the review by identifying FCD articles that need to be reviewed and clarifying whether this is mandated by the Directive itself or recommended by groups such as the Mixed Technical Group (MTG) or the Interim Working Committee on Financial Conglomerates (IWCFC).
7. Second, the FCD work plan segments the issues relating to the various articles into clusters of issues with a common theme. These themes will be:
 - definitions and terminology;
 - scope;
 - internal control requirements;
 - capital adequacy;
 - coordination;
 - reporting; and
 - other supervisory aspects.
8. Segmenting the issues makes it easier to identify further work that needs to be undertaken in order to complete the review. The paper suggests mandating workstreams in areas where further technical work is most needed, namely language, scope and internal control requirements. The paper assumes that the IWCFC's Capital advice is sufficient to cover for the review of art 6. Also, the

review will rely on on-going work in the IWCFC on coordination for art 10, 11 and 12.

9. Third, the paper contains a proposal to complete the workstreams by means of technical advice to be requested from the IWCFC. An interim review report will be discussed in the EFCC, as to decide upon the progress of the review and the necessity to take member states' own experts' contributions on board.
10. Finally, the paper suggests aligning the timelines for the FCD-review with the timelines of the CRD-review and the Solvency II project. Aligning the timelines will facilitate the inclusion in the review of substance from both sectoral developments. It will also allow the Services to incorporate some lessons of the 2007 turmoil within the review.

FCD Articles that need to be reviewed

11. The issues referred to in Article 31 and Article 20 sub 1 of the FCD and the work already carried out by the MTG and IWCFC cover almost all articles of the Directive, except:
 - Article 1 - The aim of the Directive. This is likely to remain the supplementary supervision of regulated entities that form part of a conglomerate.
 - Articles 14 and 15 - Access to information and verification.
 - Articles 16 and 17 - Supervisory powers and enforcement.

Work plan

12. The issues in the remaining articles could be clustered and addressed along the following lines:

A. Language (Article 2 & general terminology check)

This cluster would cover the work on (legal) definitions and terminology referred to in Article 20, as well as implementation problems identified by the MTG and the IWCFC. Examples of terms that need clarification are "regulated entity", "relevant competent authority", "intra group transaction" and "risk concentration".

B. Scope (Articles 3, 4, 5 and 30)

This cluster would cover inclusion of asset management companies as mentioned in Article 31, aligning the scope of FCD with the scopes of the insurance groups and the re-insurance directives as decided by the EFCC on 27 March 2007, aligning the scope of FCD with the scopes of CRD and Solvency II with respect to consolidated supervision and group supervision (including sub-consolidated levels), and the application of the identification and waiving provisions of Articles 3 and 4. The frequency of calculations and reporting as meant in art 31 will also be considered as part of this cluster.

C. Internal control requirements (Articles 6(1), 7, 8, 9 & annex II)

This cluster would cover the issues referred to in articles 6(1), 7, 8 and 9. The contagion, concentration and complexity issues that arise in a conglomerate should be adequately covered within these articles and need to be reviewed together. The

'Internal control requirements' cluster might be the most complex element of the FCD review, since it appears that the same types of risks within the same conglomerate can crystallise very differently, depending on the way the risk is being managed.

D. Capital adequacy (Article 6 & annex I)

This cluster would cover all issues addressed by the IWCFC in its Technical Advice no. 1, also mentioned in art 31. The common theme of this cluster going forward would be the cross sectoral alignment following the drafting of the Solvency II and CRD review proposals. The Commission Services will monitor these developments throughout 2008.

E. Coordination (Articles 10, 11 and 12; reflection on articles 18 and 19)

The review of current coordination practices is currently being carried out by the IWCFC's expert group on coordination. This cluster could also make use of the analyses of third country jurisdictions carried out by the IWCFC in its equivalence exercise and may draw lessons from US and Swiss coordination practices.

F. Information (Articles 14, 15 and 31)

Article 31 makes a reference to the frequency of calculations and reporting and we may have to include this in the FCD review. This issue could be added to the cluster on scope.

G. Other supervisory aspects (Articles 13, 16 and 17)

A general check on cross sectoral alignment would be useful, focusing on Article 13 of the FCD and the Consolidation Directive (2007/044/EC). The Commission Services are unaware of any recommendations to improve Articles 16 and 17 of the Directive.

H. Comitology and regulatory procedures (Articles 20, 21 and 31-34)

Article 21 was amended by Proposal 2006/0300 (COD) and came into force on 26 November 2007. This was to ensure that the European Parliament would be informed about the use of the Commission's implementing powers. In addition, the articles need to be reviewed in the light of both the implementation of Dir 2005/01 and the Lamfalussy review.

13. The Commission Services propose mandating technical workstreams for three of the clusters mentioned above. These technical workstreams regard the identified problem-areas of respectively (A) language, (B) scope and (C) internal control requirements. The workstreams would be completed by following five steps:
 - investigate Member State practices with respect to the implementation of the specific articles related to the identified problem-area;
 - explore the impact of national differences, if found, especially in light of the objectives of the FCD;

- investigate alignment of the FCD with the relevant sectoral directives;¹
- explore the impact of differences between sectoral directives and the FCD;
- assess whether current practices, given the differences found, cause implementation problems that hamper achieving the objectives of the directive.

The involvement of the EFCC and the IWCFC

14. The FCD refers to the forthcoming review in articles 20 and 21. In Article 21 “a committee for financial conglomerates” is mentioned, as to assist the European Commission in carrying out the Review. This is the EFCC. The IWCFC, in its role as an advisor in this area, may also be expected to assist.
15. The review can start by sending a Third Call for Advice to the IWCFC regarding the first two steps of the mandate – stocktaking practices and assessing the impact of differences. This advice would form the basis from which the EFCC can decide whether or not to proceed with the three other steps of the mandate – exploring differences with other relevant directives, analysing the impact of these differences, and assessing whether the objectives of the FCD are hampered because of them.
16. The Call for Advice no. 3 would build on the Commission's announcement dated 6 November 2006, which informed the chairman of the IWCFC of the need for input that takes a different approach from the input sought from the existing Level 3 committees. This input would reflect the unique nature of conglomerate supervision.
17. By delivering their advice on the first two Calls for Advice on Capital and Equivalence, the IWCFC showed they are capable of combining all the expertise available in the European supervisory community and provide workable answers to specific questions related to conglomerates' supervision.
18. Annex I contains a letter thanking the IWCFC for its technical advice on Capital and on Equivalence, and informing the Interim Committee about the FCD review roadmap. A Call for Advice No 3 is attached to that letter.
19. The advice would assist the EFCC to decide whether or not to proceed with the other steps of the review and consider the issue of sectoral compatibility.

Involvement of industry

20. The involvement of industry will be an explicit element of the FCD review. The work streams will need to be completed with the industry's view and expertise considered. The Commission Services suggests:
 - Publishing the FCD review roadmap on the EFCC website, including a public request for input by industry, focussed on implementation differences causing problems in the three identified problem-areas.

¹ Capital Requirements Directive 2006/48 and 2006/49, Insurance Groups Directive 1998/78, Re-insurance Directive 2005/68, and Solvency II

- Establishing a technical mirror working group from the industry side, nominated in principle by CEBS and CEIOPS consultative panel members/observers.
- Having joint meetings or round tables twice in 2008.

Timelines

21. The EFCC decided, on 27 March 2007, to postpone the FCD review to 2008 in order to incorporate more experiences from the directive in the review. The full review would have to be done within 9 months and be presented to the EFCC meeting in January 2009. By then the EFCC must have a clear picture of Member States practices and the need for further harmonisation in general.
22. The review should answer the question of whether the FCD is achieving its objectives of supplementary supervision of conglomerates, aimed at addressing potential problems of contagion, complexity and concentration arising in these complex groups. On the basis of the conclusions of the review, the EFCC may decide whether legislative amendments are necessary. Following that decision, the Commission Services would then prepare for a process of legislative revisions.
23. However, considering that the FCD is aimed at the supplementary supervision of conglomerates, developments in the sectoral directives have an impact on the question of whether this supplementary supervision achieves its objectives. The investigations of current practices of conglomerates' supervision can be performed, but the review of compatibility with the sectoral directives needs to be done after the discussions on the CRD-review and Solvency II have come to conclusions. The EFCC would need to include in their considerations at least the political agreements reached in both areas.
24. Secondly, the 2007 turmoil has provided both the market and the regulatory community with valuable lessons. The Joint Forum reports, attached to document EFCC 003 08 as annex III, are only examples of the value of those lessons.
25. Thirdly, the regulatory and supervisory experts who are needed to complete the workstreams of this FCD-review, are the same people who are now dealing with the CRD-review, the Solvency II discussions and the turmoil lessons. Ignoring their capacity would imply a loss of added value.
26. It follows from the above, that the Commission Services propose to extend the deadline of the review to 2009. Depending on the progress of both the CRD-review and the Solvency II legislative proposal, the final date for the delivery of the review would have to be reconsidered.
27. The IWCFC's Advice no. 3 will serve as the basis for an interim report, which can be delivered March 2009. An oral progress report can be provided at the January 2009 EFCC meeting, at which point in time the EFCC can consider the progress of the review and its timing, in the light of the debates on the CRD-review and Solvency II. The interim report will contain a stocktake of member states' practices and an analysis of the issues with the biggest impact on the objective of the FCD.