

Speech for Michel Barnier, Member of the European Commission responsible for the Internal Market and Services, delivered by Paulina Dejmek, Financial expert in Barnier's cabinet

Conglomerates Conference "The invisibilities within the most visible"

Brussels, 7 June 2010

WELCOME

Before I kick off the subject of today, how many of you arrived in Brussels through Zaventem airport? (wait) You'll find out that this has more to do with banking than you thought.

On behalf of Commissioner Barnier, I would like to start by thanking you all for being here. We feel privileged to be able to host so many experts in the field of finance in an event like this.

Ladies and gentlemen, you and I have been reading thousands of opinions on how to improve the regulatory framework for large, complex financial institutions. May I kick off the debate of today by agreeing with you, that **we don't need more regulation**.

However, as you know, Commissioner Barnier is committed to make **regulation intelligent and effective**. When it comes to the supervision of large, complex financial institutions like conglomerates, the topic of this conference, there is a lot of work on our plate to get to intelligent and effective regulation.

JOINT FORUM PRINCIPLES

Ten years ago, the G10's Joint Forum of financial sector supervisors released the **principles of supervising financial conglomerates**. The leading idea was that groups in the financial sector, which are operating in several markets and with many regulated entities, were exposed to risks, which had nothing to do with the banking business or with the insurance business, but which had everything to do with the challenge of controlling a group of many different legal entities.

These **group risks, the risks of contagion, of risk concentration, of management complexity and conflicts of interest**, justified more intense, and a different kind of supervision of the larger, more complex groups, than of the smaller, simpler groups.

An illustrative example that makes clear to me what supplementary supervision is about is the supervision on the Australian Macquarie Group. We look forward to hearing Charles Littrell this afternoon, explaining how APRA proposes to supervise groups like that, but let me try to explain.

If a company has both a bank and an airport under its control, the banking capital rules would require the bank to calculate the correct risk weights of the exposures related to the airport, or maybe even to deduct certain exposures related to the airport from own funds. This is because the banking rules require the bank to hold adequate, risk based, capital buffers. The supplementary rules, however, would require Macquarie Group to be aware of the potential contagion coming from the airport to the bank. For example, a terrorist attack on Zaventem airport (for that's partly owned by Macquarie through an investment funds entity!) may induce depositors at Macquarie Bank to run and withdraw their savings accounts. The supplementary rules would include broader governance and risk management rules that require the board of Macquarie to have, for example, contingency plans and ringfencing policies available, or take other measures to control the group risks.

The Commission supports the principles of the Joint Forum to apply supplementary supervision when appropriate.

REVIEW

In 2002, the European institutions endorsed the principles in a directive for conglomerates, the FICOD, defining conglomerates as groups with both insurance and banking activities. The review that the Commission Services carried out for the last two years, with your kind cooperation, showed that the **regulatory framework in place worked well for those who could apply it.**

However, not all supervisors could apply it as it was meant to be. The combination of applicable directives in the financial sector created a situation where some supervisors had to choose either one or the other directive, if the legal structure was organized under a holding company. This was not our objective. Even more so, for those supervisors who need these specific powers, supplementary to their sectoral powers, this problem is urgent. This is why the Commission will propose a **quick fix** next month, which must ensure that supplementary supervision can be applied in addition to sectoral supervision regardless of legal structures.

But the review revealed that more improvements were needed. When asking you what should be improved, you replied that capital treatments should be much more consistent across sectors, and that supervisory review processes for the large complex groups should not be done in a fragmented, sector based way, but on a group wide basis. You also asked us to determine who should be subject to supplementary supervision in a more risk based manner.

Last year, as a lesson learnt during the crisis, also the Financial Stability Board realized that the supervision on large, complex groups could be improved. They asked the Joint Forum to investigate the differentiated nature and scope of regulation:

“The appropriate bodies should review the differentiated nature of regulation in the banking, securities, and insurance sectors and provide a report outlining the issue and making recommendations on needed improvements. A review of the scope of financial regulation, with a special emphasis on institutions, instruments, and markets that are currently unregulated, along with ensuring that all systemically-important institutions are appropriately regulated, should also be undertaken.”

The FSB realized, that the set of available rules for the financial sector which were meant to **protect citizens** from the abuse of information asymmetry, from the abuse of not knowing or seeing what they might need to know or see, might be outdated. The rules worked as long as the rules, the business, and the citizens were dealing with the same package of services. The fragmented framework worked as long as the business was fragmented. Citizens could trust that the supervisor would see what the citizen did not see.

Today, **business structures evolved to combinations of licenses for all kinds of financial services**. Both citizens and corporates are benefiting from packages of financial services, combinations of banking, insurance and investment products and services. Companies in the financial sector innovated the way they control themselves, including non-regulated entities. Five of them, all very different from each other and all subject to the same set of directives, will tell us how they control themselves as a group this afternoon.

The rules worked for one license businesses, one bank, one insurers, one asset manager. Maybe it worked for two license firms, a firm with one bank license and one insurance license.

Does it work for firms of 100 licenses?

Does it work for firms of **2000 legal entities**, of which 1000 authorized to do whatever they wish in the financial sector?

Where business strategies of the most visible financial services providers in this society are built upon a **patchwork of regulated and non-regulated entities**, do supervisors and regulators still **see all the risks** that they need to see?

Can citizens trust that no relevant risks remain invisible?

This is what the Financial Stability Board's question was about. The Joint Forum delivered, and the FSB endorsed their advice last January. The supervisors in the first panel of today will explain you all about it, and no doubt they will explain that we can no longer ignore the risks coming from non-regulated parts of the conglomerates in the financial sector.

As they put it: "*Policymakers should ensure that all financial groups (particularly those providing cross-border services) are subject to **supervision and regulation that captures the full spectrum of their activities and risks.***"

OUTLOOK

This is some work, ladies and gentlemen. We know you're worried about more work, which may dig up things you rather didn't see. We shouldn't be afraid. This is also an **opportunity to tidy up** and get to more intelligent and effective regulation.

Today we start a debate which may last for another 18 months, and which will not be easy. We will publish the quick fix FICOD I proposal in order to allow supervisors to apply all the powers they need given the defined scope in the current FICOD. But we may want to talk about the adequacy of that scope. The Commission is committed to prepare a FICOD II which does achieve the objective of supplementary supervision, the control of group risks, where ever they come from. In the end, the overall objective remains the same: the protection of citizens from financial instability.

May we invite you to speak up and share your views with us about the following questions:

Does the **regulatory framework still fit our aim to protect citizens** from what they cannot see? How can you and we enforce supplementary supervision that makes visible whatever is still invisible today?

We look forward to an interesting debate.