



FINANCIAL CONGLOMERATES COMMITTEE

General guidance from the European Financial Conglomerates Committee to EU supervisors: the extent to which the supervisory regime in the United States of America is likely to meet the objectives of supplementary supervision in Directive 2002/87/EC

General guidance from the Banking Advisory Committee to EU supervisors: the extent to which the supervisory regime in the United States of America is likely to meet the objectives of consolidated supervision in Chapter 3 of Directive 2000/12/EC

Section 1: Introduction

Article 21(5) of the Financial Conglomerates Directive (2002/87/EC) states that the European Financial Conglomerates Committee ("EFCC") "may give general guidance as to whether the supplementary supervision arrangements of competent authorities in third countries are likely to achieve the objectives of the supplementary supervision as defined in this Directive [...]. The Committee shall keep any such guidance under review and take into account any changes to the supplementary supervision carried out by such competent authorities." Article 18(1) requires that this guidance is taken into account by the competent authority (the 'coordinator') responsible for exercising supplementary (i.e., group-level) prudential supervision when verifying whether a group, with its parent headquartered outside the Community, is subject to equivalent supervision in its home country.

Article 29(11) of the Financial Conglomerates Directive (2002/87/EC) inserts Article 56a into Directive 2000/12/EC, which states that the Banking Advisory Committee ("BAC") "may give general guidance as to whether the consolidated supervision arrangements of competent authorities in third countries are likely to achieve the objectives of consolidated supervision as defined in this Chapter [...]. The Committee shall keep any such guidance under review and take into account any changes to the consolidated supervision arrangements applied by such competent authorities." Article 56a requires that this guidance is taken into account by the competent authority which would be responsible for exercising consolidated supervision when verifying whether a credit institution, with its parent headquartered outside the Community, is subject to equivalent supervision in its home country.

Recital 13 of Directive 2002/87/EC describes equivalent supervision in terms of the objectives and results achieved from it. The recital states that regulated entities should be subject to "equivalent and appropriate supplementary supervisory arrangements which achieve objectives and results similar to those pursued by the provisions of this Directive". Recital 14 makes it clear that such equivalent supervision can, however, only exist where "third-country supervisory authorities have agreed to co-operate with the competent authorities concerned on the means and objectives of exercising supplementary supervision of the regulated entities of a financial conglomerate."

The EFCC and BAC have decided to give general guidance on the supervisory arrangements in Switzerland and in the USA, given the economic importance of Swiss and US financial groups to the European Union.

The following guidance relates to the supervision of financial conglomerates and banking groups in the USA. It is based on technical advice prepared by the Mixed Technical Group (“MTG”) Supervisory Sub-group and approved by the MTG at its meeting on 15 June 2004. In our view the objectives of supplementary supervision under Directive 2002/87/EC and the objectives of consolidated supervision under Directive 2000/12/EC are sufficiently close that this guidance addresses both topics.

The EFCC is giving guidance as to whether the arrangements of the US supervisory authorities concerned are likely to achieve the objectives of Directive 2002/87/EC, identifying individual authorities where appropriate. This guidance is intended to facilitate the making of equivalence decisions, as required by Article 18 of Directive 2002/87/EC, by EU supervisors.

The BAC is giving guidance as to whether the arrangements of the US supervisory authorities concerned are likely to achieve the objectives of the Directive 2000/12/EC, identifying individual authorities where appropriate. This guidance is intended to facilitate the making of equivalence decisions, as required by Article 56a of Directive 2000/12/EC, by EU supervisors.

This guidance was approved at a joint session of the EFCC and the BAC on 28 June 2004. Now that the guidance is available, we expect EU supervisors to take equivalence decisions in relation to particular groups at the earliest possible opportunity, to provide the necessary degree of certainty to the industry.

Section 2: Overview of the US regulatory system

The US regulatory system is based around a number of functional supervisors (i.e., different supervisors for banking, securities and insurance markets). The main supervisory agencies are outlined below. As well as this functional split, supervision is undertaken at the state as well as the federal level – in the case of insurance, all supervision is undertaken by state insurance commissioners. There can also be multiple regulators for a given sector; this is most notable in banking, where there are five federal agencies responsible for commercial banks, savings banks and credit unions.

This multiplicity of regulators means that diversified financial groups will be subject to the oversight of several regulators. There are, however, mechanisms that provide for co-ordination, such as the Federal Financial Institutions Examination Council which assists co-ordination among federal banking supervisors, or the NAIC's framework for analysing insurance groups. In recent years measures have also been taken to provide lead supervisors for diversified groups. Under the Gramm-Leach-Bliley Act 1999, the Federal Reserve has powers to act as umbrella supervisor for financial holding companies and the OTS and SEC have powers to supervise thrift and investment bank holding companies respectively.

Bank supervision	
State chartered banks	A commercial or savings bank can be chartered (licensed) as a state or a national bank. A state bank has a state banking department as its primary regulator and consolidated supervisor. There are around 6000 state chartered banks. However, legislation also requires state banks to have a (secondary) federal regulator.

Office of Comptroller of the Currency (OCC)	The OCC operates as an independent agency within the US Treasury Department and is responsible for 2100 commercial banks with national charters. Under US law, the OCC is the consolidated supervisor of a banking group where a national bank is the top parent (there are currently no such US banking groups that operate in the EU).
Federal Reserve Board (Fed)	In addition to being the US central bank, the Fed acts as the supervisor of bank holding companies and has responsibility for the oversight of financial holding companies covering diversified financial groups.
Office of Thrift Supervision (OTS)	The OTS is responsible for supervising thrift institutions (including savings banks and savings & loan associations) that opt for a national rather than state charter. It is generally the consolidated supervisor for groups that contain thrifts. Like the OCC, it is an independent agency within the US Treasury.
Federal Deposit Insurance Corporation (FDIC)	The FDIC runs the deposit insurance scheme for all banks. It also oversees the winding-up of failed banks and acts as a (secondary) federal supervisor for over 5000 state-chartered banks; the Fed acts as federal supervisor for the remaining state banks.
Capital Markets Supervision	
Securities and Exchange Commission	The SEC has wide responsibilities covering (i) conduct of business on capital markets, (ii) prudential standards for securities firms and (iii) financial reporting standards. The SEC has not, to date, undertaken comprehensive consolidated supervision but is soon to introduce two new regimes that will enable the larger US broker-dealer groups to opt for consolidated supervision.
Self regulatory organisations (SROs)	The SEC recognises a number of self-regulatory organisations that play a major role in enforcing conduct of business requirements in securities markets. These include the New York Stock Exchange and the National Association of Securities Dealers. The SEC validates SRO rules.
State authorities	Each state has public officials with responsibility for capital market issues.
Insurance Supervision	
State insurance commissions	Insurance regulation is undertaken at state level, and predominantly on a legal entity basis. The National Association of Insurance Commissioners (NAIC) aims to achieve some common minimum standards.

Section 3: Guidance on achievement of objectives

The range of authorities involved means that reaching a single conclusion on whether the US supervisory regime as a whole achieves the objectives of consolidated and supplementary supervision is difficult. Nonetheless, we are of the view that, on balance, there is broad equivalence in the US supervisory approaches, notwithstanding the caveats noted below.

Some points of a general nature can be made which EU supervisors must take into account when considering equivalence decisions for US-parented groups.

General issues

Changing supervisory regimes

As in the EU with the Financial Conglomerates Directive, a number of US supervisors are introducing new, or substantially amended, supervisory regimes aimed at delivering appropriate group-wide supervision of financial groups. The analysis that has been undertaken is based on how these regimes are expected to work and, on paper, the regimes should be capable of achieving the objectives of consolidated or supplementary supervision. What is not known at this stage, however, is how the new regimes will be implemented in practice. Logically, therefore, final judgements should depend on the actual outcome rather than the hope or expectation of a satisfactory outcome. This calls for further review once there is actual practical experience of the operation of these supervisory approaches.

Supervisory co-operation and exchange of information

EU supervisors considering the equivalence of supervision for a particular US-parented group must - in all cases - also satisfy themselves that there will be an appropriate level of cooperation from US supervisors. As made clear in Section 1 of this guidance, this is a prerequisite for any finding of equivalence. We have no reason to assume there will not be an appropriate level of cooperation, but it is vital that practical supervisory cooperation continues to be robust and productive.

In particular, the limited operational experience associated with the new regimes means that this guidance can only be tentative in respect of the nature and extent of supervisory cooperation that is envisaged (both among US authorities and with EU supervisors). EU supervisors will ultimately need to form their own overall judgment on this key issue, taking account of any bilateral discussions with the US authorities.

EU supervisors must also satisfy themselves that they would be able to obtain appropriate information from the US supervisory authorities. Federal and state supervisors generally appear to have the capacity to exchange appropriate information, and indeed many already do so with EU supervisors. It will be a matter for the judgement of EU supervisors whether there are any legal or practical constraints which would prevent the necessary degree of information exchange, or supervisory cooperation, which is required for equivalence.

Specific issues

There are also a number of points relating to the supervisory approaches adopted by particular supervisors, or in particular sectors, which EU supervisors must take into account.

One of the features of the NYSBD's supervisory approach is the use of supervisory agreements, which lay out specific features of the way a group will be supervised, including some quantitative limits. EU supervisors must clearly understand the features of the agreement governing supervision of that group, and satisfy themselves that the agreement, and its practical application, can achieve objectives consistent with the objectives of supplementary or consolidated supervision, as appropriate.

The OTS does not have a uniform approach to capital requirements at the holding company level. We understand the thinking behind this approach, given the diversity of organisations which have a thrift-holding company. However, this does mean that EU supervisors must ensure that they fully understand the way in which capital requirements are applied to a particular group, and be satisfied that this delivers an outcome that is consistent with the objectives of consolidated or supplementary supervision.

The SEC will be undertaking consolidated supervision for the first time. The proposed regimes are particular in that they are voluntary regimes, i.e., groups can 'opt-in' to the

regimes, but in our view this should not – of itself - prevent the regimes being effective overall. There are some important aspects of the SEC's CSE¹ regime that EU supervisors must take into account. In particular, EU supervisors must consider the extent of reliance by groups on the inclusion of unsubordinated long-term debt in capital for a transitional period, and consider whether this poses a problem. The CSE regime will apply Basel-like standards for capital calculation at the holding company level. Given the way in which these groups have evolved, EU supervisors must consider whether there is enough mobile capital in the group to cover the risks arising from the activities of unregulated entities. Such consideration must also take into account the application to any regulated US broker-dealers in the group of capital standards that are more onerous than the Basel standards.

The NAIC is, of course, not itself a supervisor. Nonetheless, the model laws and rules put in place by the NAIC do create a sound framework for the achievement of many of the objectives of consolidated supervision and supplementary supervision. Where the relevant US supervisor is a state insurance commission, EU supervisors must consider the extent to which the state commission has implemented the NAIC's model rules in its state legislation, and whether this implementation is likely to achieve the relevant objectives. EU supervisors must also consider the extent to which state insurance commissions have gone further in their approach to group-wide supervision than proposed by the NAIC's framework, particularly in the area of group-wide capital calculations, which are not provided for under the NAIC's model rules.

Review

Given a number of points covered above, and because it will be necessary to review how supervisory cooperation is working in practice, the EFCC and BAC would intend to review this guidance by 2006 at the latest.

¹ Consolidated Supervised Entities.