MIXED
TECHNICAL
GROUP
On the prudential regulation
of financial conglomerates

THE FOLLOW UP OF THE SECOND MAPPING EXERCISE ON EU FINANCIAL CONGLOMERATES

- A summary of the findings by the Mixed Technical Group -

2002-04-11

The follow up of the second Mapping Exercise on Financial Conglomerates

Two separate mapping exercises of EU financial conglomerates have been carried out. The general objective of these exercises was to increase the knowledge about the number and structure of financial conglomerates within the EU. The second mapping exercise also aimed at identifying those conglomerates that would be subject to the proposed Directive.

In the autumn of 2001 the Mixed Technical Group (MTG) decided to make a further extension of the second mapping exercise to analyse

(1) the importance of financial conglomerates in terms of their percentage share of financial activity within the EU;

(2) whether the scope of the proposed Directive included all financial conglomerates that were relevant from a macro-prudential perspective.

A special Working Group was established and given the mandate to carry out this task. The Group reported the results to the Mixed Technical Group in March 2002. This report is based on the Group's findings.

Before commenting on the conclusions of the Group's work, it needs to be pointed out that the methodology used by the Working Group offers indications, but not exact quantitative data, about financial conglomerates' market shares and the scope of the proposed Directive. Nevertheless, the assessment of the Working Group is that the results are sufficiently reliable for offering a good basis for decision.

The results of the Group's analysis indicate that financial conglomerates, as defined by the proposed directive (applying a 10% cross-sectoral criterion), account for a fairly large part of the EU market as a whole. In banking, financial conglomerates represent 27% of the market in terms of deposits or balance sheet totals. Financial conglomerates are less important in the insurance market than in the banking market. Their market share in terms of premium income represent 20% of the total EU market. The importance of financial conglomerates varies considerably among Member States. In a few Member States such groups account for more than half of deposits and premium income. There are also Member States where financial conglomerates have a marginal market share.

The definition of a financial conglomerate, and in particular the cross-sectoral criterion applied in the proposed directive, is a crucial factor for determining the number of financial conglomerates and their market share. If the cross-sectoral criterion was to be lowered from the currently proposed 10% to 5%, the number of financial groups that would be subject to the proposed directive would increase from 38 to 80, or from 27% to 45% of the banking market based on balance sheet totals. These results indicate that there are many cross-sectoral financial groups, but in most of them one financial sector clearly dominates. The most frequent type of financial conglomerate in the European Union, according to the definition of the proposed Directive, is a financial group that has its main business in banking.

An important question to the Working Group was whether the proposed Directive covers all cross-sector groups that are relevant from a macro-prudential perspective.

The Working Group started by identifying 23 major groups with cross-sectoral activity that would not be covered by the proposed Directive. However, a relevant policy issue is whether these 23 groups, that would fall outside the proposed directive, actually cause supervisory concern. Some Member States consider that these groups should not cause supervisory concern as their different financial activities are covered by sectoral directives (both on a solo and on a sector group level), which to some extent are relevant for cross-sector groups as well. Other Member States consider that at least some of these groups have such a significant cross-sectoral activity that the cross-sector interrelationships within the groups should be taken into account to a far greater extent than what is done under the sectoral directives.

The Working Group analysed to what extent a lowering of the cross-sectoral threshold from 10%, according to the proposed Directive, to 5% would increase the coverage. The result was that 10 of the identified 23 groups would then be covered by the Directive. The Working Group then decided to analyse the structure of the remaining 13 groups, that would be outside the Directive's scope. The Group observed that most of these groups did not have an important cross-sector activity in terms of market shares. However, there were at least four exceptions. These four groups, which would not be subject to the proposed directive, are all major financial groups. Furthermore, the activities of their smallest financial sector account for at least 5% in terms of market share. A tentative conclusion is that although lowering the cross-sectoral threshold from the proposed 10% to 5% would increase the number of groups that would be subject to the proposed directive, such a lowering of the threshold would not be efficient in targeting those groups that potentially could be relevant from a macro-prudential perspective.

There was a debate on the most efficient method for identifying cross-sectoral groups of macro-prudential relevance. Several alternative possibilities were mentioned such as targeting those cross-sectoral groups that have activities in their smallest financial sector exceeding a certain market share (on a national or EU basis) or a certain absolute amount. The last method would also take account of group activity outside the European Union.