EUROPEAN COMMISSION
Directorate-General for Financial Stability, Financial Services and Capital Markets Union

REGULATION AND PRUDENTIAL SUPERVISION OF FINANCIAL INSTITUTIONS
Banks and financial conglomerates

CONSULTATION DOCUMENT

DIRECTIVE 2002/87/EC ON THE SUPPLEMENTARY SUPERVISION OF CREDIT INSTITUTIONS, INSURANCE UNDERTAKINGS AND INVESTMENT FIRMS IN A FINANCIAL CONGLOMERATE

Disclaimer

This document is a working document of the European Commission services for the purposes of consultation and does not prejudge any decision or action that the European Commission may take regarding the Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate.

The views reflected in this consultation document do not constitute any policy position and should not be understood to constitute a formal proposal by the European Commission.

The responses to this consultation document will provide important guidance to the European Commission when preparing the evaluation staff working document.

You are invited to reply **by 20 September 2016** at the latest to the **online questionnaire** available on the following webpage:
http://ec.europa.eu/finance/consultations/2016/financial-conglomerates-directive/index_en.htm

Please note that in order to ensure a fair and transparent consultation process **only responses received through the online questionnaire will be taken into account and included in the report summarising the responses**.

This consultation follows the normal rules of the European Commission for public consultations. Responses will be published unless respondents indicate otherwise in the online questionnaire.

Responses authorised for publication will be published on the following webpage: http://ec.europa.eu/finance/consultations/2016/financial-conglomerates-directive/index_en.htm#results

CONTENT OF THE CONSULTATION DOCUMENT

I. Objective of the consultation

This consultation is designed to gather evidence on the Directive on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate ("FICOD")[1] and its implementation to date (including regulatory technical standards[2]), as part of the evaluations that the European Commission ("Commission") is carrying out under its Regulatory Fitness and Performance Programme ("REFIT").[3]

The evaluation looks at whether the current FICOD regulatory framework is proportionate and fit for purpose, and delivering on its objective to identify and manage group risks, and in particular whether FICOD has:

a) contributed to enhanced financial stability;

b) safeguarded creditors' and policyholders' interests; and

c) promoted the competitiveness of financial conglomerates within the EU and at international level.

In line with better regulation principles, the evaluation will assess the relevance,[4] effectiveness,[5] efficiency,[6] coherence[7] and EU added value[8] of the legislation.

However, the evaluation will not consider possible future changes to the legislation. If required, this would be done in a separate impact assessment. Further information about

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1 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 and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC, (OJ L 35, 11.2.2003, p.1).

2 Commission Delegated Regulation (EU) 2015/2303 of 28 July 2015 supplementing Directive 2002/87/EC of the European Parliament and of the Council with regard to regulatory technical standards specifying the definitions and coordinating the supplementary supervision of risk concentration and intra-group transactions (OJ L 326, 11.12.2015, p. 34); and Commission Delegated Regulation (EU) No 342/2014 of 21 January 2014 supplementing Directive 2002/87/EC of the European Parliament and of the Council and Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for the application of the calculation methods of capital adequacy requirements for financial conglomerates (OJ L 100, 3.4.2014, p. 1).

3 http://ec.europa.eu/smart-regulation/refit/index_en.htm

4 Relevance looks at the relationship between the needs and problems in society and the objectives of the intervention. In other words: "Is EU action still necessary?"

5 Effectiveness analysis considers how successful EU action has been in achieving or progressing towards its objectives. In other words: "Have the objectives been met?"

6 Efficiency considers the relationship between the resources used by an intervention and the changes generated by the intervention (which may be positive or negative). In other words: " Were the costs involved reasonable?" Typical efficiency analysis will include analysis of administrative and regulatory burden and look at aspects of simplification.

7 Coherence involves looking at a how well or not different actions work together. In other words: "Does the policy complement other actions or are there contradictions?" This encompasses both "internal" coherence e.g., the different articles of a piece of legislation, and "external" coherence e.g., between interventions within the same policy field or in areas which may have to work together.

8 EU-added value looks for changes which it can reasonably be argued are due to EU intervention, rather than any other factors. In other words: "Can or could similar changes have been achieved at national/regional level, or did EU action provide clear added value?"

the scope of the evaluation and the issues to be examined can be found in the roadmap for this evaluation.

Please submit your response to this public consultation by 20 September 2016. You are invited to reply to the questions in the questionnaire by using the following link: http://ec.europa.eu/finance/consultations/2016/financial-conglomerates-directive/index_en.htm

Please always use this questionnaire even if you would like to submit documents.

The results of this consultation will be assessed and included in the evaluation staff working document, which will be made publicly available on https://ec.europa.eu/finance/consultations/2016/financial-conglomerates-directive/index_en.htm#results

You are invited to read the privacy statement attached to this consultation for information on how your personal data and contribution will be dealt with.

Financial conglomerates

Financial conglomerates are large financial groups which provide services and products in at least the banking/investment and insurance sectors of the financial market place. FICOD aims at identifying and managing risks that are inherent to these groups that are active in several financial sectors to ensure financial stability. FICOD therefore focuses on the so-called "group risks" - *i.e.*, potential risks of multiple gearing[9] and excessive leveraging[10] of capital, risks of contagion,[11] risks related to management complexity,[12] risk concentration,[13] and conflicts of interest.[14]

FICOD does not replace the existing supervision of the different, regulated sectoral parts of a financial conglomerate (banks and investment firms,[15] asset management

9 Double/multiple gearing typically occurs within groups that are not fully consolidated at every level and where one entity holds regulatory capital issued by another entity in the same group and the issuer is allowed to count the capital in its own balance sheet; multiple gearing occurs when the parent's externally generated capital is geared up a third time.

10 Excessive leveraging is where the parent issues debt and down streams the proceeds as equity or other forms of regulatory capital to its regular subsidiaries.

11 While intra-group transactions and exposures can facilitate synergies among the various parts of a financial conglomerate, these very same transactions and exposures that creates strong links among the entities in the conglomerate can also lead to negative contagion within (but also outside) the conglomerate and complicate resolution.

12 Most financial conglomerates are very large, complex groups combining several business lines (both regulated and unregulated under financial legislation) and hundreds (sometimes thousands) of entities. This naturally may lead to challenges with regard to corporate governance and supervision.

13 A possible excessive build-up of risk coming from a variety of sources, for example due to exposures to or from individual counterparties, groups of counterparties or specific products. In a conglomerate, when the exposures are aggregated across the group, these may be more significant.

14 With several different sectors combined and many different business models and interests combined, it is difficult to handle conflicts of interests between the group as whole and its individual entities as well as among individual entities to minimize instances where a decision taken in the interest of one part of a financial conglomerate is not harmful to other parts or the conglomerate as whole.

15 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338); and Regulation

companies,[16] alternative investment fund managers,[17]and insurance and reinsurance undertakings[18]) but introduces a layer of supplementary supervision of the regulated entities in the group on top of the sectoral legislation.[19] This allows supervisors to look across sectors – addressing any blind spots in the sectoral legislation and avoiding the circumvention of prudential requirements set out in sectoral legislation. To this it should be added that financial conglomerates can also contain an industrial part (un-regulated from a financial legislation perspective and non-financial), which also affects the overall risk situation of the financial conglomerate.

Legislative background

FICOD was adopted in December 2002. Following lessons learnt during the financial crisis an amended FICOD was adopted in November 2011.[20] The amended FICOD was a "quick-fix" directive which enabled supervisors to perform consolidated banking supervision and insurance group supervision at the level of the ultimate parent entity, even where that entity is a mixed financial holding company, and closed a gap where some supervisors were forced to choose between applying the sectoral legislation and applying FICOD. This also meant that supervisors are now equipped to better oversee the conglomerate's ultimate parent entity when the parent is a mixed financial holding company. On top of that, the 2011 amendment included revised rules for the identification of conglomerates, introduced a transparency requirement for the legal and operational structures of groups, and brought alternative investment fund managers within the scope of supplementary supervision. The amended FICOD has been applicable since 11 June 2013 with the exception of the rules regarding alternative investment fund managers, which have been applicable since 23 July 2013.

The amended FICOD required the Commission to deliver a review report before 31 December 2012 assessing the effectiveness of FICOD. In April 2011, the Commission requested a Call for Advice from the Joint Committee of the European Supervisory Authorities' Sub-Committee on Financial Conglomerates ("JCFC") focusing on: (a) the scope of application, especially the inclusion of unregulated entities; (b) internal governance requirements and sanctions; and (c) supervisory empowerment.[21] Following

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(EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

16 Meaning a management company as defined in Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast), (OJ L 302 17.11.2009, p. 32), as amended by Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 (OJ L 257/186, 28.8.2014).

17 As defined in Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, (OJ L 174, 1.7.2011, pages 1 to 73.

18 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 (Solvency II) (OJ L 335, 17.12.2009, p. 1). In October 2013, the European Commission proposed a second Quick Fix Directive postponing the application date of the Solvency II Directive to 1 January 2016. The first Quick Fix Directive states that the application date for Solvency II is 1 January 2014.

19 *I.e.*, legislation as listed in footnotes 13 to 16.

20 Directive 2011/89/EU of the European Parliament and of the Council 16 November 2011 amending Directives 98/78/EC, 2002/87/EC, 2006/48/EC and 2009/138/EC as regards the supplementary supervision of financial entities in a financial conglomerate, (OJ L 326, 8.12.2011, p. 113).

21 The European Commission's Call for Advice no. 4, Fundamental FICOD-review, 20.4.2011.

the publication of the Basel Committee Joint Forum ("Joint forum") principles for the supervision of financial conglomerates in September 2012[22] and the EBA, EIOPA and ESMA's (the "ESAs") response to the Call for Advice in October 2012,[23] the review report was published in December 2012 (the "2012 Report").[24]

The 2012 Report identified a number of weaknesses in FICOD as amended and concluded that several of them could be addressed in a future revision of FICOD: (1) scope: the inclusion of unregulated entities that are relevant for the risk profile of a financial conglomerate within the scope of FICOD, the thresholds identifying a financial conglomerate and the waivers available to supervisors; (2) enforcement: identification of the ultimately responsible entity; improved sanction powers; and (3) managing group risks: insight into the availability of capital at conglomerate level; clarifications regarding resolution. The report was accompanied by a Commission staff working document detailing the conclusions made in the 2012 Report.[25]

The 2012 Report was to be followed up by legislative proposals if deemed necessary. But the regulatory and supervisory environment regarding credit institutions, insurance undertakings and investment firms was still uncertain at that time, pending negotiations and the entry into force of revised sectoral legislation. Therefore, the Commission decided not to propose a legislative change to the amended FICOD during 2013 but to wait for new legislation to have an impact in the market place before making a decision on next steps.

In 2015, FICOD as amended was featured in the 2016 Commission Work Programme as part of the REFIT programme. It was stated that the evaluation will assess whether FICOD can be considered "fit for purpose."

In the continuation of this document references to "FICOD" should be understood to include all amendments to FICOD.

Current context

Financial conglomerates are very much present in Europe. Based on 2015 figures, the JCFC identified 78 financial conglomerates headquartered in the EU/EEA.[26] Total end 2014 assets of the EU financial conglomerates were equal to EUR 24.46 trillion, which corresponds roughly to 1.7 times the size of the EU28 GDP.

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22 Basel Committee on Banking Supervision, Joint Forum, Principles for the supervision of financial conglomerates, September 2012.

23 EBA, EIOPA and ESMA's response to the Call for Advice on the Fundamental Review of the Financial Conglomerates Directive, 2.10.2012.

24 The Report on the review of the Directive 2002/87/EC of the European Parliament and the Council on the supplementary supervision of credit institutions, insurance undertakings and investments firms in a financial conglomerate from the Commission to the European Parliament and the Council, COM(2012) 785 final 20.12.2012.

25 Commission staff working document accompanying the report, SWD(2013) 71 final 15.3.2013

26 https://www.eba.europa.eu/-/esas-update-list-of-identified-financial-conglomerates. The approximate distribution of financial conglomerates is as follows: Austria 3, Belgium 3, Bulgaria 1, Denmark 2, Finland 4, France 10, Germany 7, Ireland 1, Italy 8, Malta 1, Netherlands 9, Norway 5, Portugal 2, Spain 4, Sweden 6 and the United Kingdom 11.

Financial conglomerates are often large, very complex groups with many different types of entities (regulated and unregulated from a financial legislation perspective) and activities (financial and non-financial) gathered under one umbrella. Recent trends indicate that more "traditional" financial conglomerates (bank and insurance) have expanded their activities into investment banking. Mixed-activity groups other than financial conglomerates as defined under FICOD have also expanded into new business areas. For example, asset management companies have expanded into the area of banking, insurers are expanding into securities activities, and non-financial groups (*e.g.*, automotive groups) have expanded into financial activities, with the creation of structures covering all financial services domains. It is not clear to what extent these changes in the market place has led to changes in the risk-taking behaviour of conglomerates, whether they have led to less diversification in the financial system, and whether the financial system has become more interconnected. Moreover, FICOD currently does not cover many of these entities and activities.

There have also been a number of further changes in the regulatory landscape since FICOD was adopted. Sectoral legislation for the banking and insurance sectors has broadly now stabilised following the entry into effect of the new capital framework for banks (2014) and the solvency framework for insurers (2016). The Joint Forum published its updated "Principles on the supervision of financial conglomerates" in 2012. The ECB took on the task of single supervisor in November 2014 and this includes responsibility for a number of financial conglomerates. The Basel Committee published its conclusions on the review of prudential consolidation practices at the end of 2014.

In September 2015 the Commission launched a call for evidence to consult all interested stakeholders on the benefits, unintended effects, consistency, gaps in and coherence of the EU regulatory framework for financial services. FICOD was included within the remit of this exercise. A very small number of respondents highlighted amongst other things the need to consider the interaction and possible inconsistencies between FICOD and other financial legislation.[27]

Against this background, it is important to assess to what extent FICOD has been able to deliver on its objectives to identify and manage risk and contribute to financial stability. Considering all the changes and developments that have taken place in recent years, both in the market place and on the policy and legislative side, now is therefore the appropriate time for a REFIT evaluation.

You are asked to kindly reply to a number of questions relating to the above listed issues. Please explain your responses and, as far as possible, illustrate them with concrete examples and substantiate them with supporting data.

[27] The summary feedback to the call for evidence can be found by using the following link: http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/docs/summary-of-responses_en.pdf

II. Public consultation

II.A. Scope of the Directive

Entities and activities

When assessing how successful FICOD has been in achieving its objectives, it is important to consider whether the Directive is effective in identifying risks in a financial conglomerate. The question is whether supervisors are able to capture the right groups (and entities within those groups) as well as the right activities.

FICOD uses a two-step approach to determining which entities fall within the scope of the Directive. As a first step, it identifies groups that contain entities that are so-called financial sector entities (they are all regulated entities) and these entities must at least carry out the following financial sector activities to a significant extent: banking or investments services activities, and insurance activities. As a second step, FICOD uses a quantitative threshold (*see below*).

Regarding entities and activities, one important question is whether all relevant entities that may impact the financial conglomerate's overall risk profile are included within the scope of FICOD. For example, are all relevant activities of regulated financial sector entities sufficiently captured by FICOD now? In this context, it is noted that regulated entities active in the financial markets such as ancillary insurance service undertakings or pension funds are not currently within scope. Similarly, special purpose entities, which under certain circumstances may be covered by sectoral financial legislation, are not explicitly covered by FICOD. Moreover, it may be important to consider the activities of unregulated entities. Currently mixed financial holding companies are subject to a certain degree of coverage, but in principle unregulated, non-financial entities (*e.g.,* financial technology firms, or firms providing similar services to regulated entities, and industrial firms) within a financial conglomerate are not captured, considered or monitored under FICOD - even if they are relevant to the risk profile of the group. There is also an issue with the identification of a mixed financial holding company and a mixed activity holding company. The boundary between a mixed financial holding company and a mixed activity holding company is determined by size metrics which are open to judgement and amendment rather than being determined by, for instance, the potential affect that the failure at the level of a particular holding company may have on financial stability. The identification of an entity as a mixed financial holding company or a mixed activity holding company may affect the supervisory tools available to the competent authority. The issue of inclusion or exclusion of entities and activities may also raise issues of consistency of treatment of activities and entities across various pieces of EU financial legislation.

The question of what activities and entities to include within the scope of FICOD has been highlighted in the Joint Forum principles, the ESA's response to the Call for Advice, and in the 2012 Report.

The 2012 Joint Forum principles emphasise the importance of recognising organisational complexity and the potential risks it poses, including risks arising from all entities that affect the overall risk profile and financial position of the financial conglomerate. These principles state that each unregulated entity may present different risks to a financial conglomerate and each may require separate consideration and treatment. In deciding which unregulated entities are relevant, consideration should, at a minimum, be given to risks arising from activities of unregulated entities, in particular from operating and non-operating holding companies, unregulated parent companies, subsidiaries and special purposes entities. The principles also say that supervisors should consider impact from direct/indirect participations and influence, interconnectedness, risk exposures, risk concentration, risk transfer, risk management, intra-group transactions and exposures, strategic risk and reputational risk.[28]

The ESAs also recommended in their reply to the Call for Advice that a broader set of financial risks should be taken into consideration, irrespective of whether they stem from a regulated or unregulated activity, when identifying a financial conglomerate. At the time, the ESAs saw a case for including institutions for occupational retirement provision into the scope of FICOD and also recommended clarifying the treatment of special purpose entities. They also recommended that mixed financial holding companies should be subject to the FICOD requirements, even if they are unregulated.

The 2012 Report states that regulated financial entities are exposed to group risks from the unregulated, non-financial part of the financial conglomerate but it makes no conclusion about whether to extend the FICOD requirements to wider non-financial and financial groups and if deemed necessary, how.

Questions on activities and entities

1(a) How successful has FICOD been in identifying the right entities and activities to fall within the scope of the Directive? Has there been any lack of legal clarity and/or predictability about what entities and activities fall within the scope of FICOD affected, and if so, has that had any impact on: (i) risks to financial stability; (ii) the level playing field; and (iii) the level of protection of creditors and policyholders.

1(b) To what extent is FICOD clear on which entities qualify as mixed financial holding companies, including in situations where there is a chain of holding companies making up several subgroups with a large complex group?

2(a) Mixed financial holding companies, financial holding companies and insurance holding companies fall within the scope of FICOD and in particular a capital requirement is imposed at that level of the group. However, supervisory authorities may not have direct powers of supervision over those holding companies such that they can require those holding companies to change their capital structure. Has this had any impact on the effectiveness of FICOD in identifying and managing group risk?

2(b) Other unregulated, non-financial entities (and their activities) that are relevant to the risk profile of the financial conglomerate are not included within the scope of supplementary supervision - for instance mixed activity holding companies are

[28] Joint Forum, *Principles for the supervision of financial conglomerates*, September 201, page 6.

excluded. Has this had any impact on the effectiveness of FICOD as a tool to identify and manage group risk?

2(c) What would be the costs involved in including such entities and activities, including legal and operational?

Thresholds and waivers

The second step in identifying which financial conglomerates to include within the scope of FICOD is comprised of quantitative thresholds. Currently, there are three thresholds:

Threshold 1: The ratio of the balance sheet total of the regulated and unregulated financial sector entities in the group to the balance sheet total of the group as a whole should exceed 40 percent (mainly financial).[29]

Threshold 2: For each financial sector the average of the ratio of the balance sheet total of that financial sector to the balance sheet total of the financial sector entities in the group and the ratio of the solvency requirements of the same financial sector to the total solvency requirements of the financial sector entities in the group should exceed 10 percent (significant in both sectors).

Threshold 3: The balance sheet total of the smallest financial sector in the group exceeds euro 6 billion (significant cross-sectoral activities).

Clear, transparent and predictable thresholds are a crucial component in ensuring that the identification process works so that FICOD can be effective in achieving its objectives. It is important that all parameters (for example, assets and capital requirements) used to calculate the quantitative thresholds are clear, transparent and equivalent for the different sectors so as to not skew the outcome. Similarly it is important that the accounting treatment of assets across sectors (including in particular the valuation methods) is not leading to unequal outcomes. A key issue to consider is whether the quantitative thresholds are sufficiently risk based and proportionate to bring within the scope of FICOD those financial conglomerates that actually or most likely present risks.

The clarity, transparency, predictability and success of FICOD is closely linked to the wide scope of national discretion to apply waivers in the process of identifying whether a financial conglomerate falls within the scope of FICOD. FICOD currently allows supervisory authorities to decide to waive the requirements of FICOD where applying supplementary supervision is not necessary, is inappropriate or would be misleading with respect to the objectives of supplementary supervision. These waivers can be granted where a group meets only one of Threshold 2 and Threshold 3 outlined above. However, supervisory authorities do not have the discretion to include groups for which they think supplementary supervision may be appropriate (for example, groups who fall only slightly below the threshold conditions).

[29] This threshold only applies when the parent of the group is an unregulated entity (*see* FICOD Article 2(14)(a)(i) compared to Article 2(14)(b)(i)).

The waivers also are closely linked to the level playing field conditions for cross-border financial conglomerates versus the multi-sectoral financial groups that do not meet the thresholds in FICOD. Closely linked to the level playing field issue is also the interaction between FICOD and the capital requirements regulation as the latter foresees alternatives to how bank sector group capital ratios are calculated. These alternatives depend on supervisory discretion and may result in significantly different outcomes in terms of capital ratio of not only the banking part of a financial conglomerate but also of the financial conglomerate as a whole. [30] It may be useful to reflect on what the effect of FICOD, as well as of its interaction with the capital requirements regulation, has been on the level playing field among financial conglomerates as well as on the level playing field in respect of financial conglomerates versus non-financial conglomerates, both within Europe and on an international level.

In line with international policy work that has expressed a greater need for assessing and addressing risk stemming from a wider group of entities and activities, the 2012 Report also mentions that the current identification process has weaknesses and that threshold conditions raise questions as to whether they are sufficiently risk based[31] (given their fixed amounts in both thresholds 2 and 3). The 2012 Report highlights that supervisors find that the operation of the thresholds can hamper the proportionate approach of applying supplementary supervision to those groups whose cross-sectoral risks are significant enough to warrant additional scrutiny.

The ESAs in their reply to the Call for Advice said that waivers should be risk based as they create level playing field issues because of different application by supervisors, but also because it could be legitimately questioned whether they are compatible with the objectives of FICOD. FICOD mandates the ESAs to issue common guidelines aimed at the convergence of supervisory practices with regard to the application of waivers in the identification process but this has not yet been done.

Questions on thresholds and waivers

3. To what extent are the quantitative threshold rules in FICOD:

   (a) clear and effective (in terms of, for example: drafting, parameters used to calculate them *e.g.,* assets and capital requirements, accounting treatment of assets across various sectors, are indicators that apply to all relevant sectors in a financial conglomerate equivalent, do all financial institutions that are part of a banking group have solvency requirements);

   (b) predictable for the industry; and

[30] *I.e.,* the application of the exception in Article 49 of the capital requirements regulation in combination with the application of Annex 1 of FICOD read in conjunction with the regulatory technical standards on capital.

[31] Report from the Commission to the European Parliament and the Council: The review of the Directive 2002/87/EC of the European Parliament and the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (COM(2012) 785 final), page 6. *See* also the Staff Working Document accompanying the 2012 Report, SWD(2013) 71 final, pages 8 to 13.

(c) create costs either for supervisors or entities? Are any of the costs unnecessary?

(d) is the application of the thresholds transparent?

4. Considering the quantitative threshold rules in FICOD, has the effectiveness of FICOD in identifying and managing group risks been affected to any extent by the fact that thresholds are not risk based?

5. To what extent do you consider that the current quantitative thresholds have provided a bias for or against the inclusion of certain types of groups?

6. To what extent has current national discretion to use waivers impacted: (i) financial stability; and (ii) the level playing field, both within Europe and internationally?

II.B Financial conglomerate risk management – "group risk" management

Being part of a group saddling different financial sectors may add to the usual sector specific risks that sectoral groups need to tackle. The general objective of supplementary supervision is therefore to identify and manage the financial conglomerate risks (group risks) that exist or may arise and to prevent regulatory arbitrage. The supplementary supervision framework assumes that sector specific risks are sufficiently addressed in sector specific legislation.

The group risks are generally considered to be the following:

- capital – which is about capital calculation and risk aggregation in groups, for example the issue of double or multiple use of capital in the group;
- complexity – As groups grow in size and complexity (across sectors) it may become more challenging to manage and supervise the operation of the business and the links between entities;
- concentration - A possible excessive build-up of risk coming from a variety of sources, for example due to exposures to individual counterparties, groups of counterparties or specific products. In a financial conglomerate, when the exposures are aggregated across the group, these may be more significant than on a purely sectoral basis;
- contagion – the risk of difficulties from one part of the financial conglomerate spreading across entities;
- conflicts of interest – decisions that are taken in the interest of one part of a financial conglomerate may not be beneficial for other parts, or for the financial conglomerate as whole.

The next section will look at how FICOD requirements aim at addressing these group risks under the headings: capital adequacy; corporate governance and risk management processes; risk concentration and intra-group transactions; stress testing and risk management under differing structures.

Capital adequacy

The capital requirements for authorised entities on a stand-alone and consolidated basis are defined by the sectoral legislation dealing with the authorisation of financial firms. Article 6 of FICOD requires Member States to ensure that regulated entities have in place adequate capital adequacy policies at the level of the financial conglomerate, and requires supervisors to check the capital adequacy of a conglomerate. The methods for calculating capital adequacy defined in Annex 1 of FICOD aim at ensuring that multiple use of capital is avoided.

The Joint Committee's Capital Advice from 2007 and 2008[32] revealed a wide range of practices among national supervisory authorities in calculating available and required capital at the level of the conglomerate. The regulatory technical standard developed under FICOD Article 6(2)[33] should ensure uniform conditions of application of the calculation methods for determining the amount of capital required at the level of the financial conglomerate, and ensure that only transferable capital is counted as available for the regulated entities of the financial conglomerate. This should also ensure a robust and consistent calculation of capital adequacy across Member States.

Questions on capital adequacy

7. Are the rules in FICOD (including Annex 1) clear as to what capital adequacy at the level of the conglomerates means and what calculations are required from a financial conglomerate? Are the relevant entities included for the purpose of calculating the capital adequacy requirements?

8(a) What is the added value of the FICOD capital adequacy calculation, taking into consideration that each financial sector in the financial conglomerate is subject to capital adequacy rules at the sectoral level?

8(b) What are the costs for financial conglomerates and / or supervisors related to capital adequacy calculations? Do they entail any unjustified additional burden on financial conglomerates or supervisors?

8(c) How does the regulatory technical standards on capital interact with sectoral legislation? Does the interaction between FICOD capital adequacy requirements and the relevant sectoral legislation; (i) ever result in the requirements of one financial sector being applied to entities belonging to another financial sector; and (ii) lead to difficulties regarding earnings distribution at sectoral level and / or conglomerate level?

9. FICOD does not contain any explicit provisions allowing supervisors the discretion to require additional capital to be held against specific cross-sector risks in the financial conglomerate. Has this had any impact on the supervisory effectiveness of FICOD?

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32 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2002L0087:20110104:EN:PDF.

33 Commission Delegated Regulation (EU) No 342/2014 of 21 January 2014 supplementing Directive 2002/87/EC of the European Parliament and of the Council and Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for the application of the calculation methods of capital adequacy requirements for financial conglomerates (OJ L 100, 3.4.2014, p. 1).

10. To what extent did the regulatory standard on capital clarify the application of the methods set out in Annex 1 of FICOD?

11. The regulatory technical standards on capital made it clear that under certain circumstances some types of surplus capital in the sectoral parts can be transferred to the level of financial conglomerate. What impact has this had on risks that relate to intra-group loss covering?

Corporate governance and risk management processes

Financial conglomerates tend to be large, often complex, groups which combine businesses across sectors, across borders and in a range of entities (both regulated and unregulated). The number of entities involved in financial conglomerates can run into the hundreds, on occasion even thousands. As the number of entities grow, the management and control of these complex entities becomes more difficult. In order to measure, monitor and manage risk and ultimately optimise risk versus return within a financial conglomerate at both operating entity and aggregate group level, the financial conglomerate needs excellent risk-management processes and internal control mechanisms.

Governance generally refers to a range of policies which cover how an entity or group is controlled and directed. It concerns the relationships between the management and stakeholders of the group and also the structure of how the group is organised and managed. Good governance ultimately ensures appropriate management of risks in a group and should also ensure compliance with the rules on a financial conglomerate basis. Given the complexity involved in these groups and their cross-sectoral character, there may be conflicts of interest. Good governance should include strategies that balance and consider these varied interests and ensure that group or conglomerate strategies are not detrimental to different parts of the conglomerate or the conglomerate as a whole.

Governance should also include consideration of the interaction between the ultimate parent of the financial group and the owners of the group. Financial conglomerate structures may mean that there are non-financial entities above the top level of the financial conglomerate – for example if an industrial group owns a financial conglomerate. Decisions taken at this level may have an impact on the business of the financial conglomerate, but supervisors may not be properly empowered to act to receive information on these entities.

FICOD requires financial conglomerates to have sound risk management and internal control mechanisms in place to ensure that risk monitoring systems are well integrated into the organisation and sound reporting and accounting procedures. There is also a "fit and proper" requirement for persons who effectively direct the business of the financial conglomerate (they must be of sufficiently good repute and have sufficient experience to perform relevant duties). FICOD also requires financial conglomerates to submit information on their legal structure and governance and organisational structure to the competent authority, as well as to publish this information annually.

It is also important in considering risk management in financial conglomerates to consider how risk stemming from different entities within a financial conglomerate is managed. As noted in Section I, financial conglomerates have become more active in a range of sectors, including an expansion of banks into asset management activities. For example, asset management companies have expanded into the area of banking and insurance, insurers are expanding into securities activities. It is not clear to what extent, if any, these changes in the market place has led to changes in the risk-taking behaviour of conglomerates, whether they have led to less diversification in the financial system, and whether the financial system has become more interconnected. Moreover, FICOD currently does not cover many of these entities and activities.

The ESAs in their response to the Call for Advice highlighted that a key issue in relation to governance was the identification of an ultimate responsible entity in a financial conglomerate, which could help ensure efficient supervision of these groups (and ultimately ensure better compliance by conglomerates) as it would allow an all-encompassing assessment of group risks. The ESAs set out criteria for how this entity could be identified, and what the requirements could look like.

As highlighted in the 2012 Report, related to the issue of the ultimate responsible entity is how the resolution framework interacts at the financial conglomerate level. The banking side of financial conglomerates are required to comply with the provisions in the Bank Resolution and Recovery Directive. However there is no harmonised resolution regime for financial conglomerates.

Questions on corporate governance and risk management processes

12(a) Have the FICOD rules on governance, risk management (including capital management) and internal controls contributed to sound governance in financial conglomerates and has there been an impact on the organisation of conglomerates?

12(b) To what extent have the FICOD rules on governance, risk management and internal controls have added value compared to the sectoral rules?

13. To what extent, if any, does the absence of an EU wide resolution framework for financial conglomerates impact the effectiveness of FICOD?

Risk concentration and intra-group transactions

As explained in Section II A, there may be a number of entities in a financial conglomerate which are not currently captured by FICOD (unregulated, non-financial etc.) that may nonetheless be relevant for the risk profile of the financial conglomerate.

There is also a risk of contagion across the financial conglomerate. This term refers to the risk that difficulties in one entity or sector in the financial conglomerate can spread to other entities in the financial conglomerate, through close group relationships or because brand names are shared and reputational damage spreads. A lesson from the crisis was that intra-group transactions that are beneficial in normal times may be contagious during times of stress, allowing losses to spread across the group.

One of the key tools supervisors have in the monitoring and control of group risks is the monitoring of intra-group transactions and risk concentrations. Intra-group transactions involve the monitoring of transactions between members of the same group to allow for greater understanding of the exposures between entities and to monitor (and eliminate at a group level) any possible intra-group creation of capital. By risk concentrations is meant the possible excessive build-up of risk coming from a variety of sources, for example due to exposures to individual counterparties, groups of counterparties or specific products. In a financial conglomerate, when the exposures are aggregated across the group, these may be more significant than on a purely sectoral basis.

FICOD requires reporting on both significant intra-group transactions and significant risk concentrations but gives supervisory authorities the flexibility to define the format for this reporting. FICOD also allows supervisory authorities the option to set quantitative limits on intra-group transactions and risk concentrations – but does not require them to do so. The only quantitative limit is that any intra-group transaction which is greater than 5 percent of the total amount of capital adequacy requirements at the level of a financial conglomerate must be considered significant. Additionally, supervisors may apply the dominant sector's (banking or insurance) rules to the conglomerate as a whole which may create level playing field issues between banking-led and insurance-led conglomerates.

The regulatory technical standards on intra-group transactions and risk concentrations adopted by the Commission in 2015 aim to bring greater harmonisation to this issue by setting out certain types of intra-group transactions and what risk exposures should be considered.[34] They also specify that transactions which are "part of a single economic operation" should be added together for the purpose of meeting the 5 percent threshold in Article 8.

Questions on risk concentrations and intra-group transactions

14. To what extent, if any, have the rules in FICOD on intra-group transactions and risk concentrations that empower supervisors to monitor intra-group transaction and risk concentration enhanced the supervision of financial conglomerates, taking into consideration that each sector is subject to its respective sectoral legislation?

15. To what extent, if any, do you observe a difference in the treatment of banking-led and insurance-led conglomerates with respect to risk concentrations and intra-group transactions?

16. To what extent, if any, have the regulatory technical standards on intra-group transactions and risk concentrations been effective in coordinating supervision of intra-group transactions and risk concentrations?

Risk management in differing structures

When FICOD was developed, it was designed to address the bancassurance model which was popular at the time. The term bancassurance is used to characterise either one of two

[34] Commission Delegated Regulation (EU) 2015/2303 of 28 July 2015 supplementing Directive 2002/87/EC of the European Parliament and of the Council with regard to regulatory technical standards specifying the definitions and coordinating the supplementary supervision of risk concentration and intra-group transactions (OJ L 326, 11.12.2015, p. 34).

basic operating models which combine banking and insurance businesses. Over recent years a change in the market structures of groups active in more than one financial sector has been observed. A recent trend is for mixed-activity groups other than just financial conglomerates as defined under FICOD to expand into new areas of business. For example, asset management companies are expanding into the area of banking and insurance and insurers are expanding into securities activities, with the creation of structures covering all financial services domains.

In addition, there is also a trend that non-financial groups acquire financial entities or expand into financial operations. For example, today most automotive companies have their own financial arm. However, there is a significant differentiation in their organisational structures and development compared to the traditional financial conglomerate.

The ESAs acknowledged in their response to the Call for Advice that financial conglomerates may be exposed to risks from the non-financial parts of the group. However, they concluded that it was premature to conclude that FICOD requirements should be extended to cover these entities, and if so, how.

Questions on risk management in differing structures

17. To what extent has FICOD provided supervisors or Member States with tools and powers to address the risks which may stem from the new structures mentioned above?

II.C. Supervisory powers and supervisory coordination

FICOD also sets out a framework for supervisory cooperation among those supervisory authorities involved in the supervision of the entities within a financial conglomerate, this includes those involved in different sectors, as well as across borders (within the EU and with third countries).

FICOD sets out the criteria for identifying the "coordinator" which is the competent authority with the responsibility for exercising the supplementary supervision. Where a regulated entity is at the head of the financial conglomerate this will be the competent authority that has authorised that regulated entity. Where the head of the financial conglomerate is an unregulated entity (*i.e.*, the mixed financial holding company) the coordinator will be the competent authority that has authorised the regulated entity that the mixed financial holding company is the parent of. FICOD also sets out a number of criteria for identifying the coordinator where the situation is less clear – for example where two regulated entities have their parent as the same mixed financial holding company.

FICOD contains a number of tasks for the coordinator with regard to the exercise of supplementary supervision. This includes assessing the financial conglomerate's compliance with the capital adequacy requirements; the requirements on risk concentration and intra-group transactions; and an assessment of the financial conglomerate's structure, organisation and internal control systems. It also includes the responsibility for the coordination and dissemination of relevant supervisory information.

One further concept in relation to supervisory cooperation is the distinction FICOD draws between competent authorities and "relevant competent authorities." FICOD defines relevant competent authorities as: (a) competent authorities responsible for the sectoral group-wide supervision (in particular of the ultimate parent); (b) the coordinator; and (c) any other competent authority who the authorities in (a) and (b) deem to be relevant.

Relevant competent authorities are more involved in the supplementary supervision, alongside the coordinator, and must be involved in certain key decisions – for example they must be consulted when competent authorities are deciding whether to apply a waiver. The consequence of the determination of the relevant competent authorities is that there may be situations where a competent authority is involved in the supervision of an entity or entities in a financial conglomerate but is not deemed 'relevant' and so is excluded from certain key decisions (those competent authorities who are not relevant competent authorities are just informed of the outcome of these decisions).

As part of enhancing the supervisory cooperation under FICOD, the ESAs developed guidelines on the convergence of supervisory practices relating to the consistency of supervisory coordination arrangements for financial conglomerates. These coordination arrangements set out how the various competent authorities involved in the supervision of financial conglomerates should cooperate and work together – including how information is exchanged and how decisions should be taken. The guidelines offer practical guidance on how competent authorities should work together.

One of the significant developments since FICOD's adoption has been the creation of the single supervisory mechanism which now has responsibility for the supervision of a number of the banking-led financial conglomerates in the Banking Union. When FICOD was adopted the creation of such a supervisory body was not anticipated. As a result, FICOD refers to competent authorities being "the national authorities of the Member States" which may no longer be appropriate for the Single Supervisory Mechanism.

Questions on supervisory cooperation

18. To what extent is FICOD clear on how to identify the coordinator?

19. To what extent does the identification of a subset of relevant competent authorities out of a group of competent authorities benefit or hinder supplementary supervision?

Enforcement and sanctions

Effective enforcement requires clear identification of the entity that is ultimately responsible for regulatory compliance with conglomerate requirements. It also requires a minimum set of powers with respect to these entities. There is no EU-wide enforcement framework for financial conglomerates; instead enforcement is based on sectoral legislation. This may be leading to differences in national implementation and possible level playing field issues across Member States. It may also create a level playing field issue between those financial conglomerates headed by banks and those headed by insurers as the sanctioning regimes differ in the sectoral legislation.

Questions on enforcement

20. To what extent is FICOD effective in ensuring that supervisors can enforce compliance with the ultimate responsible parent entity in a financial conglomerate?

General question

21. We would like to invite you to make any further comments on FICOD that you may have. Please include examples and evidence where possible.