21 December 2010

Recommendations on the supplementary requirements of the Financial Conglomerates Directive for supervisory colleges of financial conglomerates.

I. Objective

This paper provides recommendations on how supervisors of European financial conglomerates can meet the requirements as defined by the Financial Conglomerates Directive (FCD), during their regular college meetings.

The “10 Common Principles for Colleges of Supervisors”, published by CEBS and CEIOPS on the 27th January 2009, define the basic principles for colleges of financial groups. These principles also apply for colleges of groups identified as financial conglomerates - as explicitly mentioned therein. Consequently, this paper neither aims to amend the CEBS and CEIOPS “10 Common Principles for Colleges of Supervisors” nor any other college paper published by CEBS and CEIOPS. Further, this paper does not define new principles and guidelines for colleges. Rather, it is meant as a supplementary document for supervisors of financial groups, that at the same time constitute a financial conglomerate, on recommendations as to how to include the requirements of the FCD, where appropriate.

In this context it is noted also that the Joint Forum, in its January 2010 report on the Review of the Differentiated Nature and Scope of Financial Regulation (DNSR)[1], recommended to cover cross-sectoral issues in colleges. The Joint Forum’s DNSR Recommendation 6 states that the international standard-setters (Basel Committee of Banking Supervision, International Organization of Securities Commissions, and the International Association of Insurance Supervisors) should work together to enhance the consistency of supervisory colleges across sectors and ensure that cross-sectoral issues are effectively

[1] http://www.bis.org/publ/joint24.pdf

reviewed within supervisory colleges, where needed and not already in place. Cross-sectoral issues do not exclusively encompass aspects of financial conglomerate supervision. However, the specific features of financial conglomerates deriving from the fact that those groups operate across the financial sectors, cause an overlap of cross-sectoral and financial conglomerate supervision.

II. Format of the college

In general, a college ought to be established and operating for all **cross-border financial conglomerates** included in the "List of groups that have been identified as financial conglomerates", published by the EU Commission[2]. Correspondingly, the coordinator[3] should strive to include financial conglomerate issues in the program of regular college meetings, established at either banking level, for a banking led Financial conglomerate, or at insurance level, for an insurance led Financial conglomerate, as much as necessary and as far as appropriate.

For **small financial conglomerates**, especially those that do not operate cross-border at all, a supervisory college is not necessary. The information exchange between sectoral domestic supervisors of a financial conglomerate is likely to take place informally.

For those financial conglomerates, whose **cross border business** is **small** relative to its aggregated and/or consolidated financial balance sheet, may or may not have a college in place. This paper does not intend to obligatory require these exceptional groups to set up a supervisory college or some kind of cross-sectoral platform, because the principle of proportionality should be taken into consideration as to whether a supervisory college ought to be established. However, it is recommended to establish some kind of regular information exchange between the coordinator, the relevant competent authorities[4] and if

[2] http://ec.europa.eu/internal_market/financial-conglomerates/supervision_en.htm
[3] As defined under Article 10 of the FCD
[4] As defined under Article 2 (17) of the FCD.

necessary other competent authorities. The regular information exchange might take place via phone, e-mail or internet.

Regular **face-to-face meetings** of the supervisors are a crucial feature of effective cooperation between financial conglomerate supervisors. The former Financial Stability Forum[5] Working Group on Market and Institutional Resilience (FSF WG) recommended supervisory colleges to have at least one face-to-face meeting per annum. Thus, it seems appropriate to expect that the coordinator and the relevant competent authorities meet in person at least once a year in the context of a supervisory college for discussing FCD topics and maybe further cross-sectoral matters.

Another important aspect to consider is which is the most **appropriate platform** for the discussion of FCD aspects. Financial conglomerates in Europe are not a homogenous type of financial groups. Rather they vary in size, grades of cross-sectoral linkages and business models. Accordingly it is for the coordinator to choose the format which suits best the individual financial conglomerate and is tailor-made to its structure. Further, the coordinator should decide which authorities are to be invited to the financial conglomerate part of a college. Obligatory participants are all (supervisory) authorities that were identified as a relevant competent authority. Furthermore, the coordinator may invite other competent authorities, if appropriate and necessary. Where relevant, the coordinator should decide whether and how to involve third-country supervisors in the college.

FCD aspects and other cross-sectoral issues may be either discussed in a **core or a general college**. These colleges may be organised for insurance or banking supervisors only, or for both. From CEBS and CEIOPS supervisory experience, in some cases FCD aspects are covered within the general colleges consisting of banking and insurance supervisors. However, it is not the intention to promote this college composition as the appropriate platform for discussing financial conglomerate topics. The coordinator may also decide to discuss FCD issues in

[5] The FSF is now known as the Financial Stability Board (FSB).

the context of a core college consisting of the relevant competent banking and insurance supervisors. It is important that the respective arrangements enable participants to have a productive discussion about FCD requirements and cross-sectoral issues.

It should be noted that CEBS and CEIOPS do not see merit in requiring additional colleges in order to cover FCD requirements and other cross-sectoral issues. There is the risk that such an approach might replicate or duplicate work for supervisors and financial companies. Furthermore, it is noted that most of the existing supervisory colleges adequately cover cross-sectoral issues. Consequently, the existing settings and meetings of colleges can be used, provided that the agenda covers the supplementary FCD subjects, which might be in different formats and/or composition (respecting the variable geometry of the involved supervisors). Colleges of financial conglomerates should not cause any replication, duplication or replacement of sectoral colleges.

III. Subjects / topics for discussion in colleges

As financial conglomerates are heterogeneous, it is not feasible at this point to list a number of topics that have to be covered in the financial conglomerate part of a college. In fact, a great variety of topics is worth being discussed between the coordinator and the other relevant competent authorities. CEBS and CEIOPS recommend having a risk-based approach instead of a simple tick-box approach for FCD requirements and/or cross-sectoral topics. Such a risk-oriented discussion most likely will include topics like the capital and liquidity situation of the conglomerate, its risk exposures, the interconnectedness of entities, its internal control mechanisms and risk management. Other topics, though, might also appear on the agenda of a meeting.

According to Article 12 of the FCD, the supervisors of a financial conglomerate shall provide each other with any information essential or relevant for the exercise of the other authorities' supervisory tasks under the sectoral rules and the FCD. The provision itself then enumerates several items which should be subject to gathering and exchange of information:

- the financial conglomerate's strategic policies;
- the financial situation of the conglomerate, in particular on capital adequacy, intra-group transactions, risk concentration and profitability;
- the financial conglomerate's major shareholders and management;
- organisation, risk management and internal control systems at financial conglomerate level;
- procedures for the collection of information from the entities in a financial conglomerate, and the verification of that information;
- adverse developments in regulated entities or in other entities of the financial conglomerate, which could seriously affect the regulated entities;

Although the list contained in Article 12 of the FCD only serves as an indicator for potential subjects for the financial conglomerate part of a college, it gives a good indication of topics that may be covered by a college. However the catalogue of topics in Article 12 of the FCD, is neither obligatory nor exhaustive. CEBS and CEOIPS recommend that the coordinator decides about potential topics and agenda points on the basis of the individual financial conglomerate's activities and its resulting risk profile.

It is the responsibility of the coordinator to prepare the agenda of a college meeting. However, all college members should have the opportunity to propose further agenda items for discussion.

IV. Exchange of information – communication tools

The coordinator and the other relevant competent authorities should be dedicated to gather and exchange all relevant supervisory information and data about the financial conglomerate's entities under their surveillance. For this purpose, it might be helpful to establish, if not already in place, a specific **web-based communication platform** which eases information sharing between the relevant supervisory authorities. Such a platform could contain relevant data, documents and other information about the financial conglomerate concerned. Further, CEBS and CEIOPS see merit in including a list of all conglomerate supervisors in such a platform. Every authority responsible for the supervision of a regulated entity of the financial conglomerate should have access to the platform. Other tools might be equally effective for establishing constant communication lines. The decision should be based upon the particularities of the respective conglomerate and follow the principle of proportionality. For example, for a small and homogenous financial conglomerate that has little business abroad, a fully fledged web-based IT-solution might be inappropriate whereas for a complex conglomerate such an equipment might be helpful, indeed. Therefore CEBS and CEIOPS recommend that supervisors of financial conglomerates with considerable cross-border activities to have a web-based platform in place.

Additionally, the college should be in regular contact with the financial conglomerate at all times. For communication purposes, it is useful to invite representatives from the financial conglomerate to college meetings on a regular basis and ask them to portray the conditions of the conglomerate, for example with regard to capital resources, risk exposures, and business strategy of the group.

V. Crisis situations

Some financial conglomerate colleges have started discussions already about the coordination of supervisory activities in case of crisis/emergency situations. It is likely that the matter will gain importance in the future and may become one of the central topics on the agenda of college meetings. Additionally, the FSB, in its work on colleges, and the European System of Financial Supervision[6] mention crisis coordination as an issue for colleges.

For CEBS and CEIOPS it is especially important that colleges of financial conglomerates sufficiently incorporate cross-sectoral matters when dealing with crisis/emergency situations. For example, it might be discussed in how far the

[6] http://eur-lex.europa.eu/JOHtml.do?uri=OJ:L:2010:331:SOM:EN:HTML

respective segments have invested in certain risk exposures and which kind of contagion risks exist between the sectors.

VI. Written agreements

With respect to the necessity of written arrangements between the involved Member States, CEBS and CEOIPS would like to refer to Principle 5 of the "CEBS and CEIOPS 10 Common Principles on Colleges of Supervisors, which says:

The Colleges of supervisors shall have agreements in place, laying out the basis for the cooperation between the involved authorities and the practical organisation of the supervisory activities of the Group on a on-going basis and in a crisis situation, including engagement with Cross Border Stability Groups.

The whole text can be found in the Annex of this paper. In line with these college principles, CEBS and CEIOPS expect that colleges of financial conglomerates have written arrangements/agreements in place.

VII. Trainings and ongoing development

During the recent crisis it was noted that in times of stress, supervisors tend to cut off information channels and exchange, rather than intensify their coordination and cooperation, because Member States want to protect their own domestic interests. This tendency is likely to cause serious obstacles for a smooth functioning of colleges, as supervisors are reluctant to share important information about the concerned financial company. Therefore, CEBS and CEIOPS, and the future EBA and EIOPA, should continue to provide seminars and training programs to promote cooperation and coordination among supervisors. Participants of these seminars could be made aware of the importance of a viable exchange between home and host supervisory authorities, which could lead to an easier and more efficient functioning of colleges. Furthermore, these exercises should train supervisors in selecting the relevant topics for their colleges. Thus a sustainable basis for cross-border supervision can be established by integrating co-operation into the collective culture of supervisors.

New impressions for colleges will result from the new European supervisory architecture, which envisage new obligations and tasks for colleges. College participants should be aware of the permanently evolving requirements for colleges in Europe and should endeavour to implement them promptly. It is envisaged that the proposed European Banking Authority (EBA) and the proposed European Insurance and Pensions Fund Authority (EIOPA) will be responsible for developing guidelines[7] for supervisory colleges. It is likely that those guidelines will be based on the CEBS guidelines[8] under the Capital Requirements Directive (CRD II) and the Solvency II Directive and will establish a convergent framework for all colleges in Europe.

Supervisors, regulators and policy makers should pay attention to international developments in respect of colleges and try to reach convergence with those as far as possible. A convergent and consistent approach to colleges would make their operation more effective and avoid duplication of work for both supervisors and financial conglomerates.

VIII. Recommendations for the inclusion of FCD and other cross-sectoral requirements in relevant supervisory colleges

Accordingly CEBS and CEIOPS propose the following conditions for the inclusion of FCD requirements (and other cross-sectoral issues) in regular college sessions:

1. For every financial conglomerate included in the “List of groups that have been identified as financial conglomerates”, published by the EU Commission[9], a platform for discussing FCD issues should be set up within the existing college structure (established at either banking level, for a banking led Financial conglomerate or at insurance level, for an insurance led Financial conglomerate).

[7] See Article 21 of the EBA Regulation 1093/2010 and EIOPA Regulation1094/2010

[8] See http://www.c-ebs.org/documents/Publications/Standards-Guidelines/2010/Colleges/CollegeGuidelines.aspx.

[9] http://ec.europa.eu/internal_market/financial-conglomerates/supervision_en.htm.

2. The coordinator should decide about the appropriate composition of the platform for discussing FCD aspects taking into account the specific features of the concerned financial conglomerate. The decision should be subject to the principles of variable geometry and proportionality.

3. The selection of topics for discussion during the college meeting should consider the risks arising form the financial conglomerate and reflect its individual cruxes and the supplementary requirements of the FCD.

4. It may help to implement communication tools that support a fast and uncomplicated information exchange. For every financial conglomerate there should exist a list which contains all of its relevant competent authorities and all competent authorities.

5. Discussions about coordination of supervisory activities in emergency situations should adequately reflect risks arising from inter-sectoral linkages.

6. The future EBA and EIOPA, through the Joint Committee of the European Supervisory Authorities' Sub-Committee on Financial Conglomerates should provide training and seminars where supervisors learn how to handle FCD and other cross-sectoral issues adequately within supervisory colleges.

7. College principles from CEBS and CEIOPS, and the future EBA and EIOPA, should form the framework for colleges of financial conglomerates. They should be applied in a way that cross-sectoral and supplementary FCD aspects are satisfactorily covered and that work is not duplicated.

Annex

Colleges of Supervisors – 10 Common Principles, January 2009

Principle 5: The Colleges of supervisors shall have agreements in place, laying out the basis for the cooperation between the involved authorities and the practical organisation of the supervisory activities of the Group on a on-going basis and in a crisis situation, including engagement with Cross Border Stability Groups.

The aim of the agreements, which should reflect the nature, size and complexity of the particular group, is to provide a basis for cooperation between supervisors involved in the supervision of a group; to improve the overall supervision of the group and the more efficient use of supervisory resources; and to coordinate the requests from supervisors on the supervised Group. Developing a co-operative approach to Groups' supervision will enhance convergence between supervisors.

Among other issues, the agreements include: the role and responsibilities of the involved authorities, information exchange among supervisors, sharing and delegation of tasks, communication with the Group, crisis management and possible coordination of enforcement action. Different procedures and modus of operation could emerge during emergency situations depending on the nature and severity of the crisis. In emergency situations the frequency of contacts between supervisors will rise in general. While preserving a high degree of flexibility, procedures should aim at helping supervisors in considering as to which authorities to inform, and when, in a crisis situation.

With regard to crisis situations, reference is made to existing arrangements (e.g. the 2008 "Memorandum of Understanding on cooperation between the financial supervisory authorities, central banks and finance ministries of the European Union on cross-border financial stability") which provide for cooperation arrangements between relevant parties including, central banks and ministries of finance. Further procedures should clearly reflect the roles and responsibilities of Colleges and interaction with Cross Border Stability Groups.

For the supervision of banking groups, CEBS has published a template for written agreements. For the supervision of insurance groups, agreements have actually already been laid down in the "Helsinki protocol".

On a regular basis, the College of supervisors shall review the effectiveness of the arrangements in place.