

Comments Template on EBA, EIOPA and ESMA's Joint Consultation Paper (JC CP 2012 01) on its proposed response to the European Commission Call for Advice on the fundamental Review of the Financial Conglomerates Directive		Deadline: 13.08.2012 cob
Stakeholder:	European Systemic Risk Board (ESRB) Kaiserstrasse 29, 60311 Frankfurt am Main (Germany)	
<p>The question numbers below correspond to Joint Consultation Paper JC CP 2012 01</p> <p>Please follow the instructions for filling in the template:</p> <ul style="list-style-type: none">⇒ <u>Do not change the numbering</u> in column "Question".⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a question, keep the row <u>empty</u>.⇒ There are in total 10 questions. Please restrict responses in the row "General comment" only to material which is not covered by these 10 questions.<ul style="list-style-type: none">○ If your comment refers to multiple questions, please insert your comment at the first relevant question and mention in your comment to which other questions this also applies.○ If your comment refers to parts of a question, please indicate this in the comment itself. <p>Please send the completed template to joint-committee@eba.europa.eu, jointcommittee@eiopa.europa.eu, and joint.committee@esma.europa.eu, <u>in MSWord Format</u>.</p>		

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CFA Questions	Comments
General Comments	<p><u>Introduction</u></p> <p>The Joint Consultation Paper on the review of the financial conglomerates directive (FICOD) invites comments on all issues raised in the paper (which will then be submitted to the European Commission as response to its call for advice) and on the specific questions summarised in Annex H. This response mainly discusses the information requirements of the ESRB, for the conduct of macro-prudential oversight in the European Union. Hence, it provides general comments based on the questions raised by the European Commission in its call for advice, without entering into the details of the questions in annex H.</p> <p>The ESRB does not object to the publication of this response.</p> <p><u>Background</u></p> <p>In the recent response to the EBA Consultation Paper on Draft Implementing Technical Standards (ITS) on supervisory reporting requirements for institutions (CP 50)¹, the ESRB underscored its need for information on financial conglomerates, as these activities are currently not captured by existing or proposed datasets to be addressed by the three ESAs, which focus mainly on the collection of information at sectoral level. Hence, in the case of a financial conglomerate with significant activities in both the banking and the insurance sectors, the proposed reporting templates addressing requirements to banks (so called FINREP and COREP) and to insurers (Solvency II), would therefore provide only a partial overview of the financial conglomerate². In particular, FINREP/COREP follow the scope of consolidation of the Capital Requirements Directive/Regulation (i.e. investments in insurance subsidiaries are accounted for using the equity method), such that the insurance activities of banking groups are not</p>

¹ See <http://www.esrb.europa.eu/pub/pdf/CP50-European-Systemic-Risk-Board.pdf>.

² One member of the ESRB considers that once Solvency II is in place there will be no added value in the application of the Financial Conglomerates Directive to insurance-led financial conglomerates, as Solvency II already should include provisions from the current version of the Financial Conglomerates Directive.

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fully considered in the consolidation process, as the equity method is not equivalent to full consolidation. A similar approach is taken in Solvency II, according to which banking activities are consolidated by the proportional share of own funds and capital requirements calculated under the relevant sectoral rules.

The ESRB has an interest in the provision of additional information for the entire group in those cases where there may be substantial activities in both the banking and insurance sectors, i.e. for these groups, the use of a broader, accounting (namely, International Financial Reporting Standards, IFRS) scope of consolidation would be necessary, with the identification of the ultimate controlling entity being the parent or head office of the conglomerate. What is more, this basis of consolidation would also ensure that other financial activities outside the banking and insurance sectors, which may become relevant for macro-prudential purposes, are also captured. The definition of "group", as in Article 2.12 of the Directive 2002/87/EC³, provides a broadly-used and sound starting point for this. The use of the accounting (IFRS) scope of consolidation would not necessarily increase the reporting burden of financial conglomerates, because they already use this approach in their published financial statements, which are usually produced on a half-yearly (or even quarterly) basis. On the other hand, the use of the accounting (IFRS) scope of consolidation may imply that different valuation methods are used, which could have an impact in terms of costs for the financial conglomerates.

In short, the ESRB considers that the revision of the FICOD provides a good window of opportunity for improving the reporting framework of financial conglomerates. The reporting framework should disclose information concerning at least the balance sheet, income statement (or equivalent information gathered under Solvency II) and the capital adequacy of financial conglomerates. Moreover, it is important that financial conglomerates disclose a comprehensive reconciliation of their accounting balance sheet to their regulatory balance sheet.

If so required by the competent authorities, the ESRB stands ready to further work on the review of the Financial Conglomerates Directive, providing the macro-prudential perspective in such process.

³ 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 of the European Parliament and of the Council, see <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:035:0001:0027:EN:PDF>.

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1.

The ESRB supports the recommendation 1, i.e. the perimeter of supervision should be enlarged to include insurance ancillary services undertakings to enable a broader identification of financial conglomerates, and to enable that the risks are appropriately captured. Ideally, the scope of supervision should be extended to include Special Purpose Entities (SPEs) and the basis for consolidation where supervisors do not have ownership relationship with the SPEs⁴.

Additionally, the majority of ESRB members support to include Institutions for Occupational Retirement Provisions (IORPs) within the definition of financial sector, whenever risks from the IORP can materially affect the financial position of the financial conglomerate. However, two members of the ESRB would prefer to opt for option 2 (namely, maintenance of the status quo), on the basis of the following reasoning: i) the contagion risk posed by them to financial conglomerates has not been clearly demonstrated, ii) the market failures related to them have not been established, and iii) they do not pose significant amounts of risk to the financial system, given their specific function in the public sector, and, in any case, those risks would affect employers and not other entities in the financial conglomerate.

With reference to recommendation 2, the ESRB supports the idea that mixed financial holding companies, even if unregulated, should be subject to supplementary supervision, including reporting requirements. The sectoral consolidated/group supervision would allow the understanding of cross-sectoral risks, something which can be achieved through this supplementary supervision. Financial institutions are currently strongly cross-sectorally interrelated, so sectoral supervision may fall short in some occasions to fully assess and monitor the institution. From a macro-prudential angle, these cross-sectoral risks are of the essence of the work of the ESRB, as they may become the vehicle of contagion of risks from different parts of the EU financial market. At the same time, efficient supervisory practices will allow for all relevant risks to be incorporated in the supervision and will eliminate overlaps and holes in supervisory frameworks. With regards to asset management companies, the aim is to expand the scope of supervision of the entities with the closest connections. Again, this extension would allow a better understanding of the contagion, concentration and conflicts of interest across all sectors and all regulated entities.

From the perspective of information requirements, the ESRB has no specific comments on recommendation 3, except that Mixed

⁴ If supervision of financial conglomerates is extended to include SPEs and other similar entities, consideration should be given to include them within the regulatory perimeter of the prudential regulation of financial institutions (namely, banks and insurance corporations), if not already covered by them.

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	Activity Holding Companies (MAHC) and Mixed Activity Insurance Holding Companies (MAIHC) may be subject to ad-hoc reporting obligations, if considered appropriate.	
2.	<p>The ESRB supports recommendation 4, namely that the European Commission should identify and define an ultimate responsible entity for each financial conglomerate. Such a step is very important also for addressing reporting requirements at the appropriate level, in case part of the financial conglomerate falls outside the EU jurisdiction. For instance, in the case of a non-EU financial conglomerate with substantial activities in the EU, all its subsidiaries in the EU shall be referred to a financial holding company located in the EU. Such holding companies should be subject to the provisions of the Financial Conglomerates Directive and to the macro-prudential regime of the EU.</p> <p>As already mentioned in other fora, the ESRB fully supports the implementation of the Legal Entity Identifier (LEI), which in this case may help the European Commission in its task to identify the ultimate parent entity of the financial conglomerate.</p>	
3.	From a macro-prudential perspective, the ESRB has no comments on recommendation 5, which is more of a micro-prudential nature.	
4.	<p>The ESRB agrees with recommendation 6, i.e. to mandate the European Commission to develop an enforcement regime towards the ultimate responsible entity and its subsidiaries. In particular, this enforcement regime is important for the individual entities of a financial conglomerate headquartered outside the EU, in order to guarantee the timely collection of information on global and EU activities of the financial conglomerate.</p> <p>From the perspective of information requirements, the ESRB has no comments on recommendation 7.</p>	
5.	<p>The ESRB strongly supports recommendation 8, i.e. to develop a common reporting scheme for financial conglomerates, with three important caveats:</p> <ol style="list-style-type: none"> 1. The scope of the reporting scheme cannot be only limited to measuring risk concentration and intra group transactions. Also the capital adequacy requirements and the financial and economic situation of financial conglomerates should have harmonized formats, frequencies and dates of reporting. As already reflected in the 	

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Capital Requirements Directive/Regulation (addressed to banks) and Solvency II Directive (addressed to insurance companies), one of the aims of the FICOD should be to include minimum common reporting requirements for all main financial conglomerates throughout the EU, so that to have an overall picture of the risks, performance and capital requirements of both the banking and the insurance components. Indeed, one of the main limitations of the reporting frameworks enshrined in the above-mentioned sectoral Directives is that the activities of banking groups with substantial insurance subsidiaries/activities and of insurance groups with substantial banking subsidiaries/activities are not accurately measured. This proposed framework shall exist in parallel with the sectoral reporting frameworks (FINREP and COREP for banks, and Solvency II for insurers). This dual reporting, while avoiding overlaps and taking advantage of synergies, should not increase the reporting burden of financial conglomerates, since it would be based on accounting statements, which must be, in any case, prepared to meet national reporting obligations⁵.

2. The reporting scheme should be defined by asking ESAs (probably via their Joint Committee) to develop binding technical standards, not just guidelines. Indeed, for macro-prudential purposes, this information is needed on a consistent and comparable basis across countries, in order to fully capture the risks taken by the different financial conglomerates in the EU. This can be guaranteed only by developing these reporting requirements via binding technical standards, which make their application in Member States compulsory, so that harmonization across Member States is ensured. On the other hand, the development of guidelines would not reach such desired level of harmonization. The proposed binding technical standard should contain a harmonized minimum set of reporting obligations, leaving discretion for national supervisory authorities to broaden them if necessary. Binding technical standards would also allow an efficient supervision of all relevant and systemic risks across sectors, and further collaboration and share of information among ESAs and national supervisory authorities.
3. The reporting scheme should also capture information that would enable macro-prudential authorities to target

⁵ One member of the ESRB cautions against the introduction of such a reporting framework as it would require a big step forward towards harmonization using IFRS criteria, something which has not been considered in the discussion on FICOD2 or FICOD1. Moreover, the amendments made in FICOD allow supervisors, in some conditions, to apply sectoral Directives, what may break the linkage between the supervisory and accounting reporting frameworks.

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tools effectively. The data should enable policy makers identify potential arbitrage/leakages to macro-prudential rules. This should include the following:

- Information on the nature and quantum of all intra conglomerate exposures:
 - Financial guarantees between entities in the financial conglomerate.
 - Liquidity facilities between entities in the financial conglomerate.
 - Equity exposures between entities in the financial conglomerate.
 - Debt exposures (short term debt; long-term debt; debt to meet regulatory capital e.g. tier 1 and tier 2).

- Information on relevant transactions within the financial conglomerate, such as, not an exhaustive list, reinsurance and retrocession operations (as well as other agreements and transactions that shift risk exposures between entities in the financial conglomerate); provision of management, of other service arrangements (including agreements for centralised management of assets or liquidity in the financial conglomerate) or to share internal costs; and transactions that consist of several connected transactions with a third party where assets or liabilities ultimately are transferred only within the group.

- Data on the financial conglomerate's exposures to asset classes and sectors; for example, a breakdown of the total exposure and capital held against exposures to commercial real estate broken down by banking entities, funds (including SPEs), and insurance corporations within the financial conglomerate. The potential extension of these disclosures to significant individual counterparties may be explored as well.

**Annex H
Questions**

General
Comments

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2.

3.

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