

Comments Template on EBA, EIOPA and ESMA's Joint Consultation Paper 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:

IRSG (Name + Address)

The question numbers below correspond to Joint Consultation Paper JC CP 2012 01

Please follow the instructions for filling in the template:

- ⇒ Do not change the numbering in column "Question".
- ⇒ Please fill in your comment in the relevant row. If you have no comment on a question, keep the row empty.
- ⇒ 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.
 - 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.

Please send the completed template to joint-committee@eba.europa.eu, jointcommittee@eiopa.europa.eu, and joint.committee@esma.europa.eu, in MSWord Format, (our IT tool does not allow processing of other formats).

CFA Questions	Comments
General Comments	Regarding all questions, exemptions should be allowed in the supervision of conglomerates to the extent that Solvency II requirements regarding intra-group transactions and risk concentration are sufficient to cover the transmission of risks to other group entities. More generally, supplementary supervision should not overlap or contradict existing regimes.
1.	<p><u>Recommendation 1</u></p> <p>In principle, the perimeter of supervision should overlap with the scope of transmission of financial risks within the broader group and possibly beyond. To that extent, a better alignment of the two concepts should minimize potentially harmful regulatory arbitrage incentives.</p> <p>To achieve these ends, the legislative challenges are to:</p> <ul style="list-style-type: none"> (i) Identify the perimeter of financial risks; (ii) Align the regulatory scope with that perimeter. <p>It is important to note that the perimeter of risks can in some cases go beyond the accounting or legal perimeters. This would be the case for conglomerates that directly or indirectly operate unregulated and off-balance sheet SPEs/SPVs with substantial risk exposures. Traditional definitions of a regulatory group currently exclude such entities from group-wide capital or solvency calculations, at least under EU-level regulations.</p> <p>To partly allay these concerns, the current threshold under Article 3(5) should be revisited to take better account of the various channels of risk transmission, expanding the various forms of risks not only to the group itself but from a macro-prudential perspective. As foreseen under the Consultative Document of the Joint Forum (Principles for the supervision of financial conglomerates, BIS, December 2011), an assessment of the impact of the relevant entities on other regulated entities within the group (in terms of risks from direct/indirect participations, obligations, etc.) should guide the identification of the perimeters. Moreover, the identification of the perimeter of financial risks should also consider the systemic and macro-prudential risks, i.e. inter-connectivity, counter-party risks, and so forth.</p> <p>Under these principles, the IORPs should be included in the meaning of financial sector when it can be demonstrated that risk transmission occurs between the different entities within the group and beyond. If the risks of the IORP are necessarily absorbed by the entity itself (i.e. by shareholders, policyholders, etc.), and if legal constraints ensure a complete ring-fencing of capital, the IORP can be excluded from the regulatory scope, provided that macro-prudential risks can also be ruled out.</p> <p><u>Recommendation 2</u></p> <p>The complexity of a group's structure should not heighten risks or undermine effective supervision, by creating regulatory arbitrage opportunities, impeding effective resolution and recovery, or inducing contagion risks. The structures should be transparent, reflecting the strategic orientations and not aimed at masking risks. Any MAHC or MAIHC which has a material part in the financial sectors as addressed by the FICOD should be supervised as such. Where necessary, the supervisors must have</p>

	<p>the necessary tools to identify the subgroup(s) that could be included within the supervisory perimeter.</p> <p>The effectiveness of the three proposed tools should be assessed from the point of their relative costs and advantages. In this sense, although it would also ease supervision of complex groups considerably, tool 1 would also be very costly, at least in the short-run. The implementation of the “point of entry” as a top entity under tool 2 would require no restructuring but sanctions on natural persons may prove ineffective. In turn, tool 3 requires the “entry point” to be a regulated entity, which may be subject to the control of another group entity, implying that there may be conflicts between the top entity (not subject to supervision) and the supervisory efforts. In a nutshell, despite their lower costs, the latter two tools suffer from the fact that the selected points of entry may be too disconnected from the financial entities and activities within the group.</p> <p>The three tools can be effective under different circumstances. Tool 1 would most likely achieve the greatest net benefits in highly distributed groups with a large number of disconnected regulated financial entities. In those cases, the application of the other tools (as in the example on page 77 of the Joint Consultation paper) would suffer more from the issues identified above. Tool 2 could be effective in smaller groups, where the designated natural persons are also closely associated with their groups. In turn, tool 3 could be effective in groups where there is no clear hierarchical control between the top and lower entities (i.e. horizontal groups), minimizing the potential for disconnect.</p>
2.	<p><u>Recommendation 3</u></p> <p>A comprehensive assessment of risk is only possible if the supervisors are in direct contact with the entity that controls and exerts influence on all other entities within the group. The identification of such an ultimate responsible entity should enable the supervisors to (i) identify the parameters of financial risks; (ii) have direct access the board and senior management responsible for the entire conglomerate; and (iii) apply corrective actions in a timely and effective manner.</p> <p>The criterion for legal (or <i>de facto</i>) control and ability are reasonable in the determination of the ultimate responsible entity (i.e. ultimate parent company). However, identifying the listed entity as the dominant entity could be problematic in some specific cases. Such an approach could be misguided for cooperative or mutual conglomerates with listed entities. In such groups, ownership and control links tend to be highly complex and possibly circular within the group. An alternative criterion is to identify the entity that regularly publishes consolidated accounts, even though such an entity may not cover the entire scope of responsibilities covered. Care should also be given to ensure that the identification of the ultimate parent entity will not contradict with the existing practices of national supervisors where most of the entities within the risk perimeter are domestic.</p>

3.	<p><u>Recommendation 4</u></p> <p>The ultimate responsible entity should be responsible to understand, define and adequately monitor the strategy and risk profile of the financial conglomerate. The top entity should be furthermore responsible for overseeing and managing group-wide risk management and governance policies, i.e. internal control system, as well as a coordinating and directing role applicable for the entities within the conglomerate. Lastly, the ultimate responsible entity should be the reference point for group-wide supervision, fulfilling reporting requirements and providing consolidated accounts. For that purpose, a much-needed step is to develop harmonized reporting requirements that would allow comparisons across sectors and member states.</p> <p>Providing the ultimate parent a coordinating and directing role over the rest of the group is appropriate in many cases. However, such a requirement should not lead to excessive administrative burden due to disparities when the sector-specific rules are considered. In other words, the parent company should be able to enforce a general group-wide risk-management policy relating to the supervisory framework. Where sector-specific rules diverge substantially, the relevant sub-entities should have delegated authority to transform the general principles set by the top entity to comply with the sector-specific rules. Moreover, the relationship between the existing obligations of the boards and senior management and those emanating from the sought responsibilities of the top entity must be clarified as these can be challenged under company law.</p>
4.	<p><u>Comment on Part 3</u></p> <p>When assessing this question, one should first look whether such a framework is really necessary. When having the perspective of which sector is dominant within the group, the sector-specific legislation would derive the legislation. Thus, for a dominant insurance-led group, the assessment would be based on Solvency II requirements. A similar exercise could be made for banking conglomerates. Nevertheless, supplementary risks arising from mixed groups (financial or non-financial) should be addressed. Moreover, differences in national implementation could be of consequence. To the extent that the next generation EU rules are supposed to contribute to the development of the "single rule book", immediate convergence should be sought with respect to the "Pillar II" principles and in particular for the availability and use of enforcement measures applicable at the group-wide level.</p> <p><u>Recommendation 5</u></p> <p>Group-wide enforcement efforts should enable supervisors to consistently address group-wide risks, giving adequate incentives for the conglomerate (i.e. the ultimate responsible entity) as a whole to orient its risk strategies coherently and consistently across borders and its sub-entities. In turn, the sector-specific enforcement should correspond to preventing excessive individual risks. The aim of such a top-down approach should be to equip the supervisor with adequate enforcement powers to address risks in single entities, intra-group entities, and beyond (including macro-prudential risks).</p> <p>Under the dual approach, different set of enforcement powers are applicable to the group-wide responsible entity and to the sector-specific regulated entities. Due to legal concerns, this approach is substantially easier to apply, allowing supervisors to invoke the enforcement measures on entities that are in violation. Ultimate responsible entity would then be responsible for upholding the group-wide responsibilities discussed under Recommendation 5. Despite its practicality, the dual approach should</p>

	<p>not weaken or duplicate supervisory efforts. Moreover, the application of the dual approach requires a clearly specified delegation of authorities to the sector-specific entities, also discussed above under Recommendation 5.</p> <p><u>Recommendation 6</u></p> <p>Supervisors have a set of measures that are applicable at the group-level (under the dual approach mentioned above). For that purpose, a minimum set of applicable enforcement instruments should be developed, distinguishing between the two levels of supervision. The set of tools applicable to (regulated) financial conglomerates should be harmonized to the extent possible.</p> <p>Regarding MAHC and MAIHCs, the predominantly non-financial nature of activities implies that the available powers of supervisors should be restricted to capture financial risks. Thus, different enforcement instruments may be available for intermediate financial holdings (tool 1 in Recommendation 3) and the proposed “points of entry” solutions (tools 2 and 3). Despite such distinctions, the use of a specific tool should not undermine effectiveness of enforcement. In other words, the set of instruments available should not make certain tools more attractive (for conglomerates) than others.</p> <p>Regarding group-wide reporting requirements, it may be worthwhile for EIOPA to investigate the potential added value of an own risk and solvency assessment (ORSA) that would be applicable on the level of the group as a first-line preventive measure. If applied (and supervised) correctly, such an assessment can improve the information available to supervisors, equipping them with detailed information that could be used (or investigated) during an on-site inspection.</p> <p>Lastly, the measures at the disposal of supervisors should not duplicate those that are already available based on the sectoral rules envisaged under Solvency II or CRD IV.</p>
5.	<p><u>Recommendation 7</u></p> <p>The common reporting requirements could be partly addressed by other initiatives. For the insurance sector, for example, EIOPA’s common reporting templates under Solvency II, Financial Stability Board’s (FSB) templates, and ECB’s ECB templates may be applicable. Before investigating into developing new guidelines, the aim should be to avoid duplicate submissions and unnecessary reporting burden. Thus, the ESA’s should assess the adequacy of these frameworks in effect or under development.</p> <p>Nevertheless, moving gradually to a common reporting framework to address risk concentrations and intra-group transactions is needed to allow for effective supervision and comparability across sectors and borders (see response to Recommendation 5 above). A similar harmonization for the supervisory requirements to determine the triggers for supervisory action (i.e. risk concentration thresholds) is also needed.</p>
Annex H Questions	
General Comments	
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