MEMO/10/376

Brussels, 16 August 2010

Revision of the Financial Conglomerates Directive - Frequently Asked Questions

1) What are financial conglomerates?

Financial conglomerates are financial groups that are active in one or more country and operate in both the insurance and banking business. They are often large and complex. Due to their size, financial conglomerates are often of systemic importance to our economy: either for one or more Member States or even for the EU as a whole.

The fact that financial conglomerates can impact our economy was highlighted during the financial crisis in 2008. A number of financial conglomerates had difficulties and governments across Europe had to resort to large financial injections in order to keep these financial conglomerates afloat.

2) How are financial conglomerates currently supervised?

Currently, supervision in Europe is mainly done at the national level. Each single legal entity that wants to operate in the banking sector in an EU Member State needs authorisation from the national financial supervisor and needs to comply with the relevant banking regulation. The same applies for legal entities that want to operate in the insurance sector: such entities need to be authorized as insurance companies and must comply with the relevant insurance regulation. Supervision rules also allow for a group of authorised banking entities to be subject to consolidated banking supervision. Similarly, in the insurance sector, a group of authorised insurance entities can be subject to insurance group supervision.

Financial conglomerates are often active in both banking and insurance business and operate in several EU Member States. The Financial Conglomerate Directive (2002/87/EC) gives national financial supervisors additional powers and tools to watch over these firms. More specifically, the Directive requires supervisors to apply supplementary supervision on these conglomerates, in addition to the specific banking and insurance supervision.

3) What is supplementary supervision?

Supplementary supervision becomes relevant when a financial group (or a "conglomerate") consists of several legal entities that are authorised to do business in banking, insurance or other sectors of the financial services industry. The number of legal entities within a conglomerate can exceed 500 or even 1.000. All of these entities are controlled by a parent entity, where decisions are made regarding business strategies, internal governance and group-wide risk management. While a parent entity can be a regulated entity itself, such as a bank or an insurance company, it can also take the form of a holding company.

Supplementary supervision focuses on problems that can arise from:

- Multiple use of capital: supervisors are to make sure that capital is not used twice or more within a conglomerate. For example, funds may not be included in the calculation of capital on both the level of the single entity and the parent entity.
- Group risks: Group risks are risks that arise from the group structure and which are not related to specific banking or specific insurance business. They refer to risks of contagion (when risks spread from one end of the group to another), management complexity (managing more than 1.000 legal entities is a far more difficult challenge than managing 20 legal entities), risk concentration (the same risk materialising in several parts of the group at the same time), and conflicts of interest (e.g. one part of the group has an interest in selling an exposure, while another part of the group has an interest in keeping that exposure).

The 2002 Financial Conglomerates Directive allows national supervisors to monitor those risks, for example by requiring conglomerates to provide additional reporting. Supervisors can also require conglomerates to present additional risk management or internal governance measures. The Directive also requires supervisors to cooperate across sectors and across borders in order to control possible group risks.

4) Why is the Commission now proposing a revision of the Financial Conglomerates Directive?

In the light of the financial crisis, the Commission evaluated the effectiveness of the Financial Conglomerates Directive in 2008. It found that supplementary supervision, as stipulated in the Directive, could not be carried out on certain financial groups because of their legal structure. In some cases, national financial supervisors were left without the appropriate tools because they had been obliged to choose either banking or insurance supervision under the sector-specific directives or supplementary supervision under the Financial Conglomerates Directive as the definitions for banking and insurance holding companies in the sector-specific directives and for mixed holdings in the Conglomerates Directive were mutually exclusive. The main objective of the revision of the Directive is to correct this unintended consequence of the current rules.

5) What is to change under the Commission's proposal?

The proposed amendments to the 2002 Directive can be summarised as follows:

- Under the current rules, supervisors have to choose which supervision they apply when a group acquires a significant stake in another sector and when the parent entity is a holding company. It is now proposed to change this: both sector-specific (banking and insurance) supervision and supplementary supervision could be applied on the conglomerate's parent entity, also if it concerns a holding company. Banking supervision would therefore remain applicable even if the banking group acquires a significant stake in an insurance business. By the same token, insurance supervision would also remain applicable if the insurance group acquires a significant stake in a banking business.

- When justified by potential group risks as a whole, financial supervisors should be allowed to identify a group as a financial conglomerate and apply supplementary supervision. The identification process of financial conglomerates should allow for risk-based assessments, in addition to existing definitions relating to size ("quantitative indicators"). Under the current rules, the balance sheet figures are determinative when identifying conglomerates. This approach sometimes results in a list of conglomerates that are not necessarily exposed to group risks, while groups that are evidently exposed to group risks are not always included within the scope of supplementary supervision.
- Financial supervisors should be allowed to waive a group from supplementary supervision if it is small (smaller than 60 billion total assets) and if the supervisor assesses the group risks to be negligible, even if the small group meets the quantitative indicators. This should enable supervisors to allocate their resources to the supplementary supervision of larger and systemically important conglomerates.

The proposed revision of the 2002 Financial Conglomerates Directive also amends the relevant banking and insurance supervision legislation, namely the Capital Requirements Directive (2006/48/EC and 2006/49/EC) and the Directive on Supplementary Supervision of Insurance Undertakings in Insurance Groups (98/78/EC). The Commission is also currently reflecting on tying in this initiative with Solvency II, the next generation of supervisory rules for insurance and reinsurance companies in the EU.

6) When will these new rules come into force?

With the proposal now passing to the European Parliament and the EU Member States for consideration, the Commission hopes to see the changes enter into force in 2011.

7) How does this proposal tie in with the wider work on crisis prevention and management the EU is doing? Will the European Financial Supervision Authorities be involved?

The main objective of this initiative is to restore the full spectrum of supervisory tools and powers, regardless of the legal structures of financial conglomerates. This unintended consequence of the current rules needs to be addressed as soon as possible. Nevertheless, the initiative will also strengthen the effective supervision of financial conglomerates. The Commission believes that supplementary supervision of large, complex groups, operating in several countries, can only be effective if the same supervisory approach is applied consistently across all EU Member States

As regards financial conglomerates operating in several EU countries, closer coordination between national financial supervisors will be required, particularly through the new European Financial Supervision Authorities (see IP/09/1347). The proposals regarding those Authorities are currently being negotiated between the Council and the European Parliament. The new European Banking Authority (EBA) and the new European Insurance and Occupational Pensions Authority (EIOPA) are to form a Joint Committee to oversee cooperation and coordination between national supervisors in the case of financial conglomerates.

As a follow up to this proposal and in order to assist the Commission in proposing further improvements of the framework of supplementary supervision, the Joint Committee is also expected to look into extending the scope of supplementary supervision to non-regulated entities such as Special Purpose Entities. These are legal entities where assets are stored off the groups' balance sheets. During the crisis, it became clear that contagion and risk concentration originated also from non-regulated parts of financial conglomerates. This issue has been highlighted also on international level in the context of the G20 work. It is the Commission's intention to continue to work on this issue and present further amendments to the Directive on Financial Conglomerates as regards this matter as well as other issues linked in particular to the new European supervisory structure.

More information:

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