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C O N S U L T A T I O N   R E S P O N S E

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Consultation on the Financial Conglomerates Directive (2002/87/EC) (FICOD)

Questions on activities and entities

Q1a) 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.

Finansinspektionen has not experienced any major problems in identifying the entities which fall within the scope of FICOD.
Sweden currently has six financial conglomerates and three of them are headed by mixed financial holding companies. They do however have a relatively simple structure and Finansinspektionen has not experienced any issues in this regard. Nevertheless, the possibility cannot be excluded that there may be unregulated, non-bank, non-insurance activities which may contribute to the risk profile of financial conglomerates (or indeed institutions which are not currently designated as financial conglomerates) and this may warrant further analysis, both by individual supervisors and for the further development of FICOD.

With this in mind, it is the opinion of Finansinspektionen that FICOD is largely functioning satisfactorily in this respect.

Q1b) 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?

See reply to Q1a.

Q2a) 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?*

The Swedish Act on Supervision of Financial Conglomerates gives Finansinspektionen certain direct powers of supervision over mixed financial holding companies, financial holding companies and insurance holding companies. The Act enables Finansinspektionen to order a mixed financial holding company to undertake measures in order to rectify breaches of the Act e.g. capital deficit. Finansinspektionen has therefore not encountered any issues of the effectiveness in this regard.

It may be worth exploring whether consolidating supervisors should be granted the powers under European law to issue binding decisions directly to financial holding companies, even in situations where these are not ordinarily captured within the regulatory perimeter or otherwise subject to financial supervision.

Q2b) 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 excluded. Has this had any impact on the effectiveness of FICOD as a tool to identify and manage group risk?

Finansinspektionen has currently no relevant experience regarding unregulated, non-financial entities belonging to regulated firms or financial holding companies. The preliminary assessment of Finansinspektionen is that such entities do not significantly impact on the risk profile of the relevant groups. However, further work may be warranted in this respect.

Q2c) What would be the costs involved in including such entities and activities, including legal and operational?

Given the extensive number of companies that could possibly fall within the scope of unregulated, non-financial entities, it is rather difficult to determine legal as well as operational costs. However, the operational costs for Finansinspektionen might not be of significance since the number of cases in Sweden is limited.

<u>Questions on thresholds and waivers</u>

Q3) To what extent are the quantitative threshold rules in FICOD: 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); predictable for the industry; and create costs *either for supervisors or entities? Are any of the costs unnecessary? Is the application of the thresholds transparent?*

Finansinspektionen is of the opinion that to use solvency requirements and balance sheet totals may be the best currently available option to identify financial conglomerates. However, it must be recognized that there are considerable ambiguity involved in the practicalities of using these parameters. Solvency requirements are for the most part easy to use once the relevant entities and figures are identified, as e.g. solvency requirements are simply added. On the other hand, using balance sheet totals are more ambiguous. The balance sheet totals are seldom available for the financial sectors subtypes defined in FICOD. For instance, the balance sheet total for the consolidated situation for a bank that is already reported in Finrep is one of the few figures available, but cannot be used unless one is willing to accept a rather crude approximation of the FICOD definition of banking sector because the entities considered are not normally the same in those two cases. Alternatively, choosing a bottom-up aggregation of entities to achieve the correct balance sheet total requires clarification of which intra group eliminations and adjustments, if any, should be made in order to get workable balance sheet totals.
It is also possible that balance sheet totals or solvency requirements may not reflect underlying risks at all, for example relating to off-balance sheet actual (or contingent) exposures. Further, step-in risk may be present even in the absence of formal ownership (note the work undertaken by the Basel Committee in this respect).
The lack of guidelines with respect to ambiguities such as those mentioned makes the identification less clear, less predictable and less transparent than it would be if there existed extended guidelines.

Q4) 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?

This is a difficult topic given that it is difficult to ascertain the underlying risk of actual or contingent exposures which are not included within the regulatory parameter. In any case, every asset has some risk connected to it. Finansinspektionen sees a possibility that large amounts of off-balance sheet assets would not be recognized in the balance sheet total, and therefore not used for identification. As implied above, the incentive implications resulting from non-risk based measures could result in higher-risk actual or contingent exposures to transition into entities subject to no, or less onerous, requirements. However this does not so far appear to have been an issue in Sweden.

Q5) 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?

Finansinspektionen has not experienced a bias with respect to bank-led and insurance-led groups other than potentially capturing smaller groups where conglomerate supervision is not warranted due to their limited relevance for financial stability. While it should be recognized that it is prudent to capture more, rather than less, firms given that it is difficult to anticipate which firms will be relevant for financial stability in a potential impending systemic crisis, there could nevertheless be a bias towards more smaller conglomerates if the main purpose of FICOD is to improve financial stability.

Q6) 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?

Finansinspektionen has not actively used the waivers to exclude groups from FICOD supervision.

Questions on capital adequacy

Q7) 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?

Finansinspektionen has not encountered any difficulties regarding the overall interpretation of Art. 6 or Annex I regarding the level of calculation or which entities to include in the calculation. However, the treatment of sectoral buffer capital requirement at the level of the conglomerate is a question which merits further work in order to ensure that adequate loss-absorbing capacity remains at the conglomerate level.

Q8a) 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?

There is some added value in the FICOD calculations for banking-led or investment-led financial conglomerates since it provides useful information about holdings in the insurance sector, which in the sectoral rules in Sweden are not allowed to be consolidated according to Art. 49 of Regulation (EU) No 575/2013. However as per Q7, the role and usefulness of the buffers should be clarified and protected at the conglomerate level.
For insurance-led financial conglomerates, the added value of the FICOD calculation is not as obvious now that Solvency II is in force as related undertakings in the banking- or investment sector are included in the calculation of the group solvency according to Solvency II.
See also the response to Q8c on the need for clarification of the interaction between Solvency II and FICOD calculations.

Q8b) 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?

See the response to Q8c below. To limit the regulatory burden for insurance-led financial conglomerates clarification of the extent to which the Solvency II calculation can be used for the calculation of capital adequacy of a financial conglomerate on the same level is needed.

Q8c) 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?

As regards (i) and as mentioned above, unintended capture is clearly a risk in principle, given that differences in how Solvency 2 and CRR/CRD 4 treat the same risk result in arbitrage opportunities and therefore unintended incentives for conglomerates. As also noted, this issue is further exacerbated when conglomerates contain entities which fall outside of either regulatory perimeter (i.e. banking or insurance). Also, some articles in the regulatory technical standard (RTS) on capital are unclear as to how they interact with sectoral legislation. See response to Q7 as regards the regulatory buffers. As regards the transferability and availability of own funds, further guidance is needed on the application of Art. 4 on transferability and availability of own funds. It needs to be clarified how the assessment of transferability should be done since one could read several interpretations. For instance, should the assessment of transferability <u>within the insurance sector</u> in a financial conglomerate be assessed according to Solvency II rules and then an additional assessment be done <u>across the sectors</u> in the financial conglomerate according to Art. 4. Or should the assessment be done for each individual regulated entity in the financial conglomerate according to Art. 4, thus ignoring any assessment done according to Solvency II for the insurance part?

Art. 8 also needs to be clarified regarding the extent to which Method 1 according to Solvency II can be used for the capital adequacy calculation for an insurance-led conglomerate. And in that case, which adjustments, if any, need to be made to the Solvency II calculation in order to comply with for example Art. 4 of the RTS.

Art. 9 in the RTS is clear on which requirements of own funds to include in the capital adequacy calculation for banking-led or investment-led conglomerates. However, further guidance is needed on how the buffer requirements are included and how to consider the ICAAP and, if any, the SREP capital assessment in the FICOD capital calculation

Q9) 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?

Finansinspektionen has not had any specific cases where there has been a need to require additional capital at the level of a financial conglomerate. However this issue merits further work. As an example, and as noted above, there are significant differences between how identical risks are treated under the standardized approaches for banking and insurance activities, respectively. Further, entities may be capable of arbitraging macro-prudential and/or systemic capital requirements by shifting them from banking to insurance activities. This is a complex issue but one which needs to be analyzed further.

Q10) To what extent did the regulatory standard on capital clarify the application of the methods set out in Annex 1 of FICOD?

Some clarifications of the provisions in FICOD provided in the RTS are useful. For example, the clarification on which capital from each financial sector should be considered to be sector specific own funds (Art. 5) and which capital should be considered to be eligible under the sectoral rules for both the banking sector and the insurance sector (Art. 6). However, further guidance on the application of the RTS and possible clarifications and amendments are needed. See also the response to Q8c.

Q11) 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?

No issues have been identified. In principle we support intra-group fungibility of capital and liquidity resources, subject to the sectoral minimum requirements having been met. The fungibility of sectoral buffer requirements is a matter which may deserve to be explored – it may be sufficient to require supervisory approval for such transfers, or further constraints may be required. It should be noted that different rules may be required in periods of financial stress (this issue has been addressed, at least partly, in the BRRD).

Questions on corporate governance and risk management processes

Q12a) 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?

The FICOD rules on governance, risk management and internal control may have contributed to some extent to the sound governance of conglomerates. The rules, however, overlap the sectoral rules that regulate governance, risk management and internal control, and the FICOD set of rules are written on a higher level with less detail. Since the sectoral rules have a group perspective and cover governance, risk management and internal control with more detailed requirements the added value of the FICOD is limited. The added value is the message that conglomerates are required to have an overall perspective on these issues.

Q12b) To what extent have the FICOD rules on governance, risk management and internal controls have added value compared to the sectoral rules?

See reply to Q12a.

Q13) To what extent, if any, does the absence of an EU wide resolution framework for financial conglomerates impact the effectiveness of FICOD?

Finansinspektionen has no practical experience of the insolvency of a financial conglomerate. Finansinspektionen is not of the opinion that a conglomerate resolution framework would significantly improve the effectiveness of FICOD given the already existing regulation, and certainly not for conglomerates where the top entity is a bank. However, there may be a benefit in exploring potential issues from a recovery or resolution point of view of banking-led mixed financial holding companies, given that the BRRD (Directive 2014/59/EU) does not refer specifically to any insurance-specific requirements or constraints that may impact on the appropriate recovery options or resolution strategy. This issue warrants further consideration, even though there may be no need for specific resolution framework for financial conglomerates.

Questions on risk concentrations and intra-group transactions

Q14) 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?

Reporting of risk concentrations and intra group transactions are still considered by Finansinspektionen to be adequate tools in supervising conglomerates. With new sectoral regulations there is however a risk for unnecessary double reporting. Also, the risk of regulatory arbitrage for e.g. asset transfers between sectors, both as regards exposure risk and macro-prudential risks, should be assessed from a financial conglomerate point of view.

A common standard or template for reporting which is harmonized with Solvency II is necessary for supervisors to allow waivers of reporting of intra-group transaction and risk concentration in Solvency II (according to Art. 215.2, Directive 2009/138/EC) in order to avoid double reporting from insurance groups.

Q15) 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?

In addition to potential implications of underlying differences in treatment in banking and insurance activities, in some cases, for insurance-led conglomerates, there will be double reporting. See also reply to Q14.

Q16) 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?

It is too early to evaluate this since the Swedish reporting templates are not yet updated for the new regulatory technical standards. See also reply to Q14.

Questions on risk management in differing structures

Q17) 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?

Finansinspektionen has not experienced the so-called new structures where the use of such tools would have been considered.

Questions on supervisory cooperation

Q18) To what extent is FICOD clear on how to identify the coordinator?

This has not been a problem in Sweden as all the identified financial conglomerates so far have had a significant home bias in their business operations. Finansinspektionen could see potential problems with conglomerates with the ultimate parent undertaking in an equivalent third country and where the third country competent authority chooses not to accept the responsibility as coordinator.

Q19) 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?

See reply to Q18.

Questions on enforcement

Q20) To what extent is FICOD effective in ensuring that supervisors can enforce compliance with the ultimate responsible parent entity in a financial conglomerate?

FICOD does not ensure that supervisors can enforce compliance with the ultimate responsible parent entity if it is not a regulated entity.

General question

Q21) We would like to invite you to make any further comments on FICOD that you may have. Please include examples and evidence where possible.

The provisions in the sectoral directives on equivalence assessments between the FICOD and the sectoral directives (Art. 3.8 and 4.2 in Directive 2011/89/EC) need further guidance. Lack of guidance makes the equivalence assessment very difficult to perform with regards to for example the granularity of the assessment.

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