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COMMISSION STAFF WORKING DOCUMENT

on Directive 2002/87/EU on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (FICOD)

{SWD(2017) 273 final}

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Contents

1 Introduction

1.1 Purpose of the Staff Working Document

This Staff Working Document assesses the relevance[1], effectiveness[2], efficiency[3], coherence[4] and EU added value[5] of FICOD and its implementation to date (including regulatory technical standards[6]). It takes each of the main areas covered in FICOD – scope; capital; governance; intra-group transactions and risk concentration; supervision and enforcement – and assesses each of them against the criteria in order to assess whether FICOD remains fit for purpose.

FICOD was included under the Commission's REFIT programme in the Commission Work Programme (CWP). However, despite the best efforts of DG FISMA staff, the consultations and analysis did not produce sufficient evidence to support a full evaluation. This Staff Working Document sets out the Commission Services' analysis of FICOD and draws conclusions on the continued fitness of FICOD in achieving its objectives but does not present a full evaluation

1.2 Scope of the Staff Working Document

This Staff Working Document covers the original FICOD (Directive 2002/87/EU) and the amending Directive (2011/89/EU "FICOD1"). Where this Staff Working Document refers to FICOD, it should be read as including both the original Directive and all the amendments to it.

In addition to FICOD, there have been two Delegated Regulations (DR) adopted to support the application of the FICOD rules - the DR on the uniform conditions of application of the calculation methods for determining the amount of capital required at the level of the financial conglomerate (Commission Delegated Regulation (EU) No 342/2014 of 21 January 2014) and the DR on risk concentration and intra-group transactions (Commission Delegated Regulation

[1] Relevance looks at the relationship between the needs and problems in society and the objectives of the intervention. In other words: "Is EU action still necessary?"

[2] Effectiveness analysis considers how successful EU action has been in achieving or progressing towards its objectives. In other words: "Have the objectives been met?"

[3] Efficiency considers the relationship between the resources used by an intervention and the changes generated by the intervention (which may be positive or negative). In other words: "Were the costs involved reasonable?" Typical efficiency analysis will include analysis of administrative and regulatory burden and look at aspects of simplification.

[4] Coherence involves looking at a how well or not different actions work together. In other words: "Does the policy complement other actions or are there contradictions?" This encompasses both "internal" coherence e.g., the different articles of a piece of legislation, and "external" coherence e.g., between interventions within the same policy field or in areas which may have to work together.

[5] EU-added value looks for changes which it can reasonably be argued are due to EU intervention, rather than any other factors. In other words: "Can or could similar changes have been achieved at national/regional level, or did EU action provide clear added value?"

[6] Commission Delegated Regulation (EU) 2015/2303 of 28 July 2015 supplementing Directive 2002/87/EC of the European Parliament and of the Council with regard to regulatory technical standards specifying the definitions and coordinating the supplementary supervision of risk concentration and intra-group transactions (OJ L 326, 11.12.2015, p. 34); and Commission Delegated Regulation (EU) No 342/2014 of 21 January 2014 supplementing Directive 2002/87/EC of the European Parliament and of the Council and Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for the application of the calculation methods of capital adequacy requirements for financial conglomerates (OJ L 100, 3.4.2014, p. 1).

(EU) 2015/2303 of 28 July 2015), which this Staff Working Document also considers. The Staff Working Document will indicate where the rules in question derive from these DRs.

1.3 Structure of the Staff Working Document

This Staff Working Document follows the following structure:

- **Section 3: Background to FICOD** – this section covers the background to the Directive and its provisions and outlines the market developments in the EU concerning mixed-activity financial groups.
- **Section 4: Method –** these sections outlines the method taken in the Commission Services' analysis of FICOD.
- **Section 5: Analysis** – this section covers the analysis of the main building blocks of FICOD.
- **Section 6: Conclusions –** this section covers the Commission Services main conclusions on the effectiveness, efficiency, relevance, coherence and EU-added value of FICOD.

2 Background to the initiative

Considering all the changes and developments that have taken place in both the market place and on the policy and legislative side, the time has come to assess to what extent FICOD has been able to deliver on its objectives to identify and manage risk, to enable the supervisory authorities to effectively supervise financial conglomerates and to overall contribute to financial stability.

This section of the Staff Working Document outlines the background to FICOD. This section will set out: the definition of financial conglomerates; the purpose of FICOD; and market developments since 2002.

2.1 Definition of financial conglomerates

Financial conglomerates are large groups with significant activities in more than one financial sector (banking, investment, insurance). They tend to be complex in structure, operate across borders and the wider group can contain unregulated entities (from a financial legislation perspective) and also entities not involved in financial services.

The bancassurance model has traditionally been the most important operating model for financial conglomerates. Bancassurers are groups which combine both banking and insurance business. Bancassurers are able to offer a full range of financial products in a one-stop shopping model —from traditional banking, through mutual funds to insurance products. For insurance companies, the bancassurance model offers new distribution channels with a stable customer base, while banks are able to diversify products and enhance their profitability by selling more products utilising the same infrastructure already in place and hence reducing operating fixed/overhead costs (economies of scale). One-stop-shopping in a bancassurance group provides customers with a variety of financial products, ranging from mortgages to life and non-life insurance. The bancassurance model appears to be popular mainly in some countries: Portugal, Spain and Italy, as well as France, Belgium, and Austria. On the contrary, in Germany, the UK and the Netherlands it has never been the dominant model. In light of its dominance, FICOD was developed to focus on the bancassurance model.

Following the concept behind the traditional bancassurance model, FICOD defines financial conglomerates as groups with at least one entity in the insurance sector and at least one entity in the banking/investment sector. The group must carry out significant activities in both financial sectors. FICOD then sets out quantitative thresholds to establish the significance of the activities in the group.

Definition of financial conglomerates in Article 3 of FICOD

Threshold 1: the ratio of the balance sheet total of the regulated and unregulated financial sector entities in the group to the balance sheet total of the group as a whole should exceed 40 percent (significantly financial).

Threshold 2: for each financial sector the average of the ratio of the balance sheet total of that financial sector to the balance sheet total of the financial sector entities in the group and the ratio of the solvency requirements of the same financial sector to the total solvency requirements of the financial sector entities in the group should exceed 10 percent (significant in both sectors).

Threshold 3: the balance sheet total of the smallest financial sector in the group exceeds euro 6 billion (significant cross-sectorial activities).

Supervisory authorities may waive the requirements of FICOD if a financial group meets only 1 of either Threshold 2 or 3 and they consider the application of the FICOD requirements to be unnecessary or inappropriate.

The European Supervisory Authorities (ESAs) maintains a list of financial conglomerates identified under FICOD, included those which benefit from waivers under the Directive, for the purposes of EU law. The list of financial conglomerates maintained by the ESAs and updated at 2016 identifies 80 financial conglomerates based in the EU/EEA. To these, the list adds another 4 conglomerates headquartered outside the EU/EEA. Total end assets of the EU/EEA based conglomerates at end-2015 were equal to EUR 27.8 trillion, which correspond roughly to 1.9 times the size of the EU28 GDP (cf. Annex 1).

Table 1 reports the list of the largest 15 financial conglomerates ranked by assets with the amount of their total assets and total liabilities, the country where they are headquartered and the number of subsidiaries for each group. The table also specifies whether each financial conglomerate is also a G-SIB (Global Systemically Important Banks as identified by the FSB), a G-SII (Global Systemically Important Insurers as identified by the FSB) or a G-SII (following EBA classification).

Table 1: Total assets and liabilities of the main FICOs (2015)

Institution Name	*Country Name*	*Total Assets (€B)*	*Total Liabilities (€B)*	G-SIBs	G-SIIs	G-SIIs EBA	Number of subsidiaries
HSBC Holdings	UK	2219	2037	YES		YES	205
BNP Paribas	France	1994	1894	YES		YES	266
Crédit Agricole Group	France	1699	1601	YES		YES	261
Deutsche Bank	Germany	1629	1562	YES		YES	129
Barclays	UK	1520	1430	YES		YES	108
Banco Santander	Spain	1340	1242	YES		YES	200
Société Générale	France	1334	1272	YES		YES	203
Groupe BPCE	France	1167	1101	YES		YES	203
Lloyds Banking Group	UK	1095	1031			YES	67
ING Groep	Netherlands	1005	957	YES		YES	42
AXA	France	887	814		YES		404
UniCredit	Italy	860	807	YES		YES	154
Allianz Group	Germany	849	783		YES		498

Goldman Sachs International	UK	783	759	YES		NA
Banco Bilbao Vizcaya Argentaria (BBVA)	Spain	750	695		YES	113

Source: Commission services' analysis using SNL Financial

The fact that financial conglomerates are institutions of systemic importance is supported by the fact that the list of FICOs includes 11 of the 30 G-SIBs, 3 of the 9 G-SIIs and 24 of the 36 G-SIIs as identified by the EBA. Due to their significant links with other financial institutions and their size, the impact of their possible failure on financial stability could be very severe.

The identified financial conglomerates are mainly headquartered in the larger Member States: FR, DE, UK, ES, IT, as well as NL, but they also have subsidiaries in smaller Member States whose competent authorities also participate in the supervision of the financial conglomerates. The Netherlands have the largest value of total financial conglomerate assets with respect to its GDP (4.2 times their GDP), followed by France, the UK and Spain. This prominence may, at least in part, reflect the wider structure of financial systems where the financial markets in these Member States are larger overall than others. While also FICOs from Malta, Denmark, Italy, Sweden, Belgium and Norway exceed the size of their national economy respectively, Germany's FICOs are about equivalent in size to their countries' respective GDP, while for the remaining countries the size of their financial conglomerates is less than 100% of their countries' respective GDP. Considering that for more than two thirds of the countries hosting FICOs, the size of the latter exceeds the size of the respective economies, severe issues of financial stability could arise in case of possible failures.

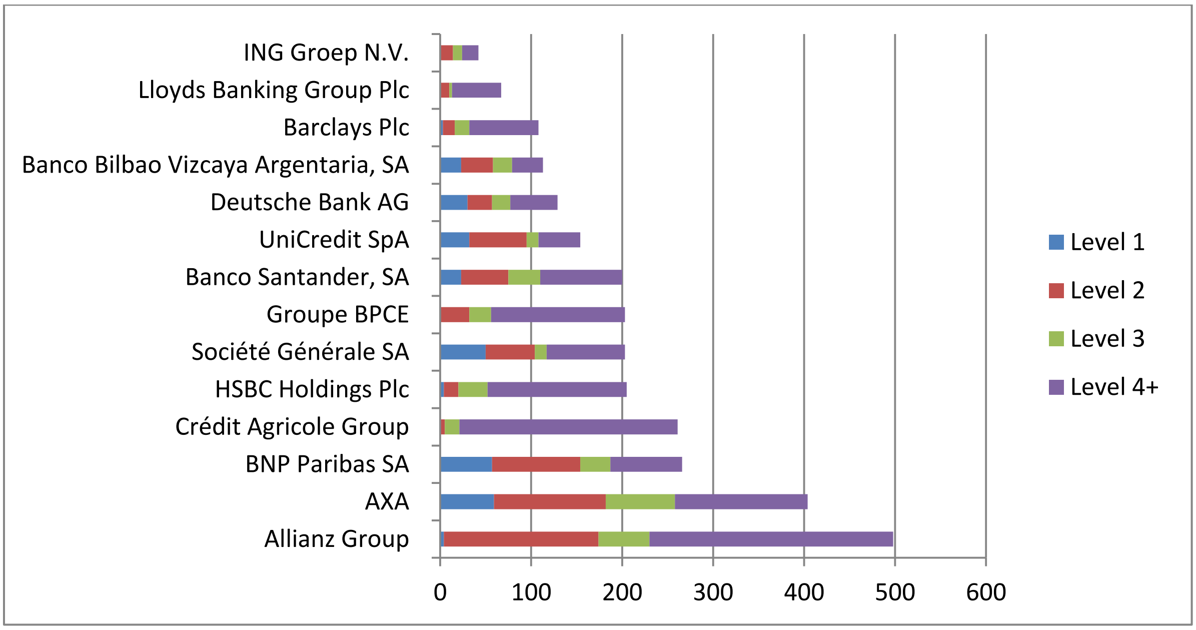
Table 2: Total assets and liabilities of FICOs as percentage of GDP by country (2015)

Country	*Total Assets (€B)*	*Total Liabilities (€B)*	*GDP (€B)*	TA/GDP	TL/GDP
Netherlands	2827	2658	677	418%	393%
France	8223	7761	2181	377%	356%
UK	6368	5983	2577	247%	232%
Spain	2505	2319	1076	233%	216%
Malta	17	16	9	195%	182%
Denmark	446	424	266	168%	159%
Italy	2341	2194	1642	143%	134%
Sweden	623	590	447	139%	132%
Belgium	468	442	410	114%	108%
Norway	396	364	348	114%	104%
Germany	3076	2914	3033	101%	96%
Finland	177	152	209	85%	73%
Portugal	113	103	180	63%	57%
Ireland	131	122	256	51%	48%
Austria	44	44	340	13%	13%
Bulgaria	1	0	45	1%	1%
Total assets and EU GDP	**27755**	**26086**	**14702**	**189%**	**177%**

Source: SNL Financial, Eurostat and own calculations

Another important aspect characterizing financial conglomerates is their level of complexity. Not only they are very large in terms of the size of their balance sheet, but they are also very complex in terms of their group structure, encompassing a large number of entities, sometimes numbering in hundreds (cf. Annex 2). Chart 1 provides an overview of the complexity of financial conglomerates reporting the number of subsidiaries by ownership level for the largest 15 groups.

Chart 1: Total number of subsidiaries by ownership level, 15 largest FICOs by total assets[7], 2014



Source: SNL Financial and own calculations.

Note: subsidiaries are categorized by their level i.e. whether they are directly owned by the holding company (level 1), or are they owned by a level 1 subsidiary (level 2), or by a level 2 subsidiary (level 3), or by a level 3 or plus subsidiary (level 4+).

Complexity is not only a matter of the number of entities composing a group, but also concerns the structure of the group itself. For example, there are some group structures where a subgroup within a large complex group qualifies as a financial conglomerate. Complexity also stems from the way different financial and non-financial activities are intertwined, from the interaction between regulated and unregulated entities, from the localization of operations both domestically and cross-border. All this complexity may lead to spillover effects either from the industrial part to the financial part and vice versa; or from unregulated entities to regulated ones; finally from one country to another one. It also naturally leads to challenges with regard to corporate governance and supervision.

[7] The number of groups listed in the chart is 14 as for Goldman no data are available on the EU subsidiaries.

2.2 The Financial Conglomerates Directive

Financial conglomerates engage in a range of financial activities which are each regulated by their own sectorial regimes. There is a risk that this sectorial focus creates gaps and misses the risks created by the interaction of these sectors within the group. Therefore, FICOD's objective is to provide a framework for supplementary prudential supervision of financial conglomerates. It aims at ensuring that supervisors have the appropriate tools to get a comprehensive view of the risks across the whole group and powers to control them.

FICOD does not replace the existing supervision of the different, regulated sectorial parts of a financial conglomerate, but introduces a layer of supplementary supervision of the regulated entities in the group on top of the sectorial legislation. This allows supervisors to look across sectors – addressing any blind spots in the sectorial legislation and avoiding the circumvention of prudential requirements set out in sectorial legislation. This supplementary layer of supervision serves the purpose of addressing specific group risks which include the following:

- **Double-gearing** – Double gearing occurs where one entity holds regulatory capital issued by another entity in the same group and the issuer is allowed to count the capital in its own balance sheet; multiple gearing occurs when the parent's externally generated capital is geared up a third time.
- **Size and complexity** – Most financial conglomerates are very large, complex groups combining several business lines (both regulated and unregulated under financial legislation) and hundreds (sometimes thousands) of entities. This naturally may lead to challenges with regard to corporate governance and supervision.
- **Contagion** – While intra-group transactions and exposures can facilitate synergies among the various parts of a financial conglomerate, these very same transactions and exposures that creates strong links among the entities in the conglomerate can also lead to negative contagion within (but also outside) the conglomerate and complicate resolution. For example, difficulties in a subsidiary in one sector may have a reputational impact on a subsidiary in another sector, particularly where brand names are shared. This may leave the financial conglomerate more vulnerable than each of the subsidiaries individually.
- **Risk concentrations** – A possible excessive build-up of risk coming from a variety of sources, for example due to exposures to individual counterparties, groups of counterparties or specific products. In a conglomerate, when the exposures are aggregated across the group, these may be more significant than on a purely sectorial basis.
- **Conflicts of interest** – With several different sectors combined and many different business models and interests combined, it is difficult to handle conflicts of interests between the group as a whole and its individual entities. There may be a risk that a decision taken in the interest of one part of a financial conglomerate is not in the interest of other parts of the group or the conglomerate as a whole.

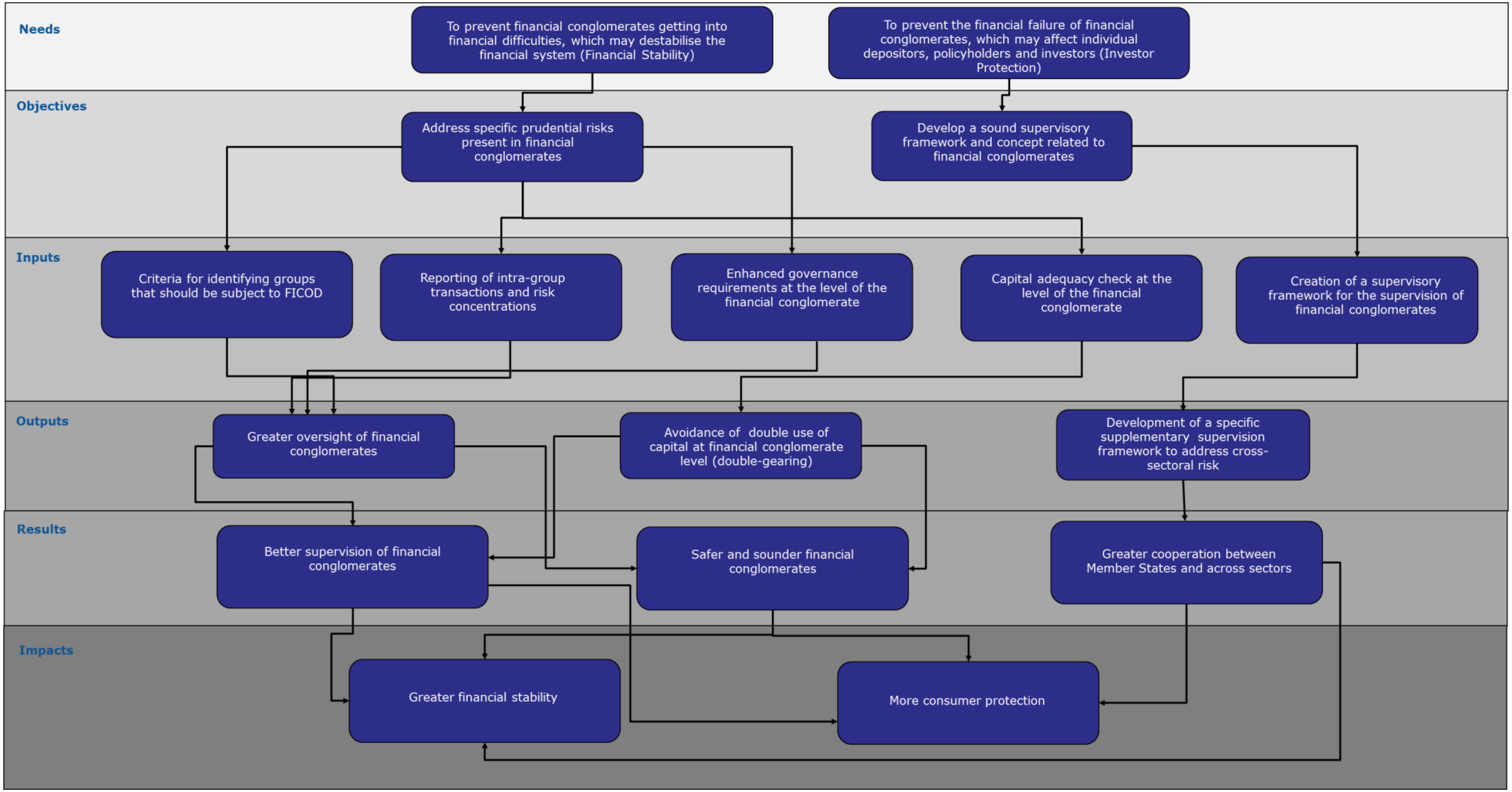
During the recent crisis there was some evidence of these risks crystallising – particularly within the banking sector. For example, during the crisis the contagion from special purpose entities to the affiliated organisation or from subsidiary entities to their parent companies created significant problems in the financial system. There was also some evidence of deficiencies in internal control or risk management also contributed to the crisis (Lumpkin, 2011).

FICOD addresses the group risks described above through imposing a series of requirements on the groups identified as financial conglomerates:

- **Capital -** Article 6 of FICOD requires Member States to ensure that regulated entities have in place adequate capital adequacy policies at the level of the financial conglomerate, and requires supervisors to check the capital adequacy of a conglomerate. The methods for calculating capital adequacy aim at ensuring that multiple use of capital is avoided.
- **Governance** – FICOD requires financial conglomerates to have sound risk management and internal control mechanisms in place to ensure that risk monitoring systems are well integrated into the organisation and sound reporting and accounting procedures are in place. FICOD also requires financial conglomerates to submit information on their legal structure and governance to the competent authority.
- **Intra-group transactions and risk concentrations** – FICOD requires financial conglomerates to report on significant intra-group transactions and risk concentrations. FICOD also allows supervisory authorities the option to set quantitative limits on intra-group transactions and risk concentrations – but does not require them to do so.
- **Supervision -** FICOD also sets out a framework for supervisory cooperation among those authorities involved in the supervision of the entities within a financial conglomerate. FICOD sets out the criteria for identifying the "coordinator" which is the competent authority with the responsibility for exercising the supplementary supervision. FICOD also contains a number of tasks for the coordinator with regard to the exercise of supplementary supervision.

The intervention logic in Figure 1 sets out how the intervention was expected to work and what FICOD was intended to achieve.

Figure 1 – Intervention logic



The intention of FICOD was to address the lack of an EU-wide prudential framework for the supervision of financial conglomerates. Its aim was to ensure the financial stability of these groups, in order to prevent harm to the wider economy and to ensure that individual depositors and policy holders were not impacted by the failure of these groups. FICOD aimed to ensure this by developing a sound supervisory framework for the supervision of these groups, which addressed the specific prudential risks arising in these groups and also addressed any loopholes in the sectorial regimes. FICOD achieved this by setting out the provisions in the Directive as set out above.

FICOD was originally adopted in December 2002. However, the global financial crisis revealed that financial sector regulation did not keep up with changes and challenges in the market place. An amended FICOD was adopted in November 2011[8]. One of the key lessons during the crisis was that in some cases, national financial supervisors were left without the appropriate tools to supervise financial conglomerates because they had been obliged to choose either banking or insurance supervision under the sector-specific directives or supplementary supervision under FICOD as the definitions for banking and insurance holding companies in the sector-specific directives and for mixed holdings in FICOD were mutually exclusive. The amended FICOD was adopted as a "quick-fix" directive which allowed supervisors to perform both consolidated banking supervision/ insurance group supervision and supplementary supervision under FICOD at the level of the ultimate parent entity, even where that entity is a mixed financial holding company. On top of that, the 2011 amendment included revised rules for the identification of conglomerates, introduced a transparency requirement for the legal and operational structures of groups, and brought alternative investment fund managers within the scope of supplementary supervision. The amended FICOD has been applicable since 11 June 2013 with the exception of the rules regarding alternative investment fund managers, which have been applicable since 23 July 2013.

The amended FICOD required the Commission to deliver a report before 31 December 2012 assessing the effectiveness of FICOD, followed by a legislative proposal if deemed necessary. In April 2011, the Commission requested a Call for Advice from the Joint Committee of the European Supervisory Authorities' (ESAs) Sub-Committee on Financial Conglomerates (JCFC) to help input into this report. The Commission published a report in December 2012 (the 2012 Report)[9] which drew on Commission staff analysis, the JCFC response to the Call for Advice[10] and the Joint Forum principles for the supervision of financial conglomerates which were published in September 2012[11]. The 2012 Report highlighted a number of areas in which FICOD could be improved, but any review of the legislation was put on hold pending the conclusion of negotiations on the sectorial regimes (namely CRDIV/CRR and Solvency II) on which FICOD builds.

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[8] Directive 2011/89/EU of the European Parliament and of the Council 16 November 2011 amending Directives 98/78/EC, 2002/87/EC, 2006/48/EC and 2009/138/EC as regards the supplementary supervision of financial entities in a financial conglomerate, (OJ L 326, 8.12.2011, p. 113).

[9] The Report on the review of the Directive 2002/87/EC of the European Parliament and the Council on the supplementary supervision of credit institutions, insurance undertakings and investments firms in a financial conglomerate from the Commission to the European Parliament and the Council, COM(2012) 785 final 20.12.2012.

[10] EBA, EIOPA and ESMA's response to the Call for Advice on the Fundamental Review of the Financial Conglomerates Directive, 2.10.2012.

[11] Basel Committee on Banking Supervision, Joint Forum, Principles for the supervision of financial conglomerates, September 2012.

2.3 Market developments

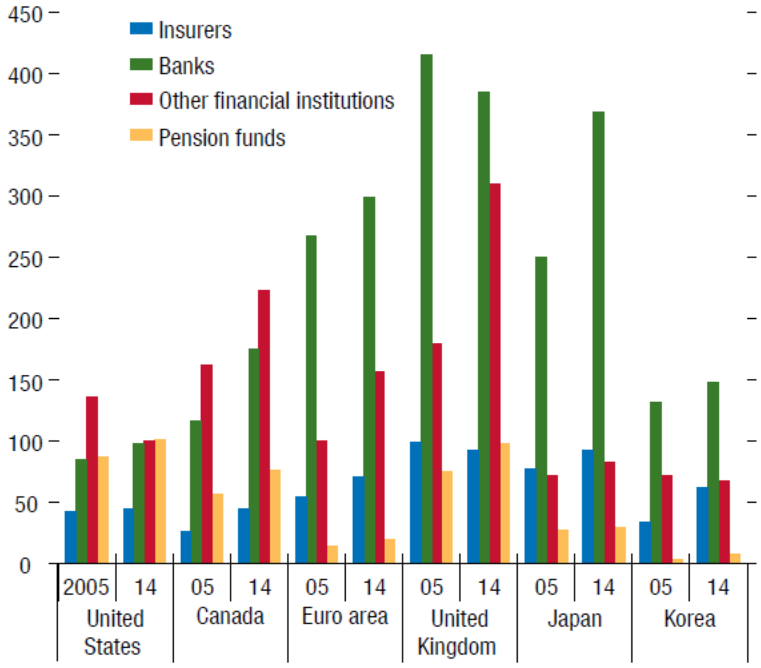
In order to properly analyse how FICOD works, it is important to understand the market conditions in which the entities under supervision operate in. This section shows how the nature of financial conglomerates and the markets in which they operate has substantially changed since the late 1990s when the Directive was conceived. This section sets out the prominence of financial entities in the economy, and then demonstrates the changes in the structures of financial groups.

Diversity in financial groups has increased

As outlined above, FICOD focuses on the bancassurance model, which was the dominant model for large financial groups at the time. However, as this section shows, the current market in mixed activity financial groups has evolved in the recent years and the bancassurance model is no longer the only business model combining financial activities. There is a trend not only across the EU, but also at global level, towards a greater variety of operating models among these mixed activity groups. For example, insurers expand into securities activities and asset managers expand into the area of banking. This section shows how other financial sectors beyond banking and insurance have gained prominence in recent years, for example the asset management industry and the shadow banking sector. These changes have also to do with the increased regulatory pressures on regulated sectors that led some activities migrate to unregulated ones. In addition, an increasing number of non-banking non-financial groups own banks.

As shown in chart 2, along with banks and insurance companies (life insurers as well as providers of property and casualty, health, and financial coverage), other financial institutions including asset managers and pension funds have gained prominence in the last decade in Europe. Together with the banking and insurance sectors, they increasingly represent an important source of long-term risk capital to the real economy, and are among the largest institutional investors.

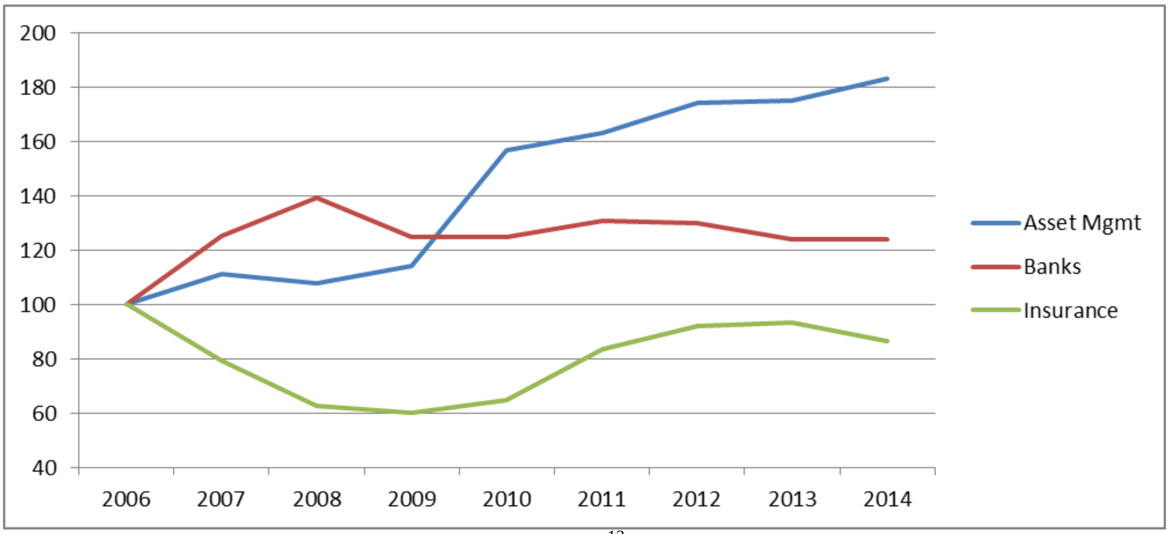
Chart 2: Relative size of financial intermediaries (percent of GDP)



Source: IMF, Global Financial Stability Report, April 2016, Washington DC

To specifically measure the shift in make-up of EU based financial conglomerates, we look at how the relative size of the different financial sectors present within a group (banking, insurance, asset management) has shifted over the years for the 10 largest not waived conglomerates in annex 1. Chart 3 shows that since the year 2006, while insurance assets decreased and banking assets remained steady, the most significant increase has been experienced by the asset management part of those groups. Chart 3 therefore supports the idea that, after FICOD was conceived and came into force, the business model of those groups has changed from the traditional bancassurance model.

Chart 3: Development of total assets by financial sectors across top 10 not-waived financial conglomerates (indexed 2006 = 100, evolution over the years)



Source: Commission Services' analysis using Capital IQ[12]

Overall, the diversification of financial groups has increased. For example, insurance groups have been increasing their non-traditional investments. These include investment not only in banking, but also in direct lending, investments via hedge funds, and third-party asset management. For example, in Germany, nonlife insurers have increased their proportion of non-traditional non-insurance assets.[13]

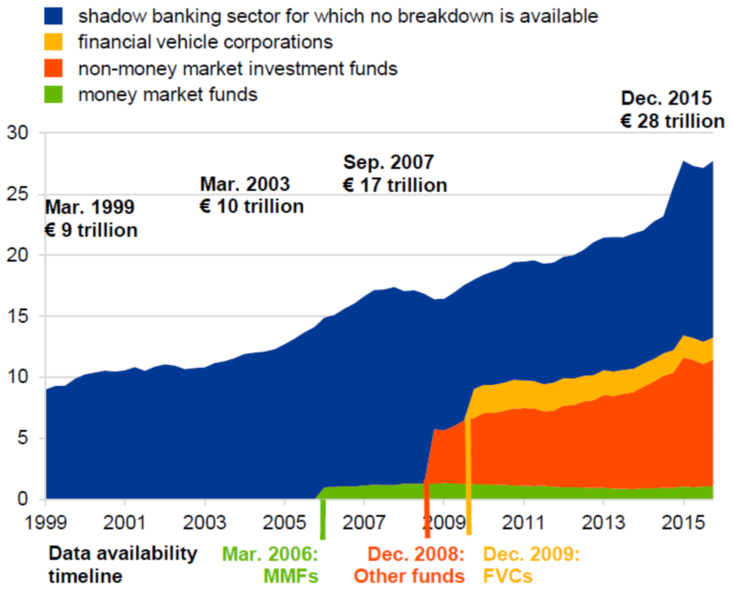
Overall the importance of the non-banking, non-insurance sector in the EU economy has increased

Chart 4 shows the growth in recent years of the non-banking non-insurance sector i.e. the so called shadow banking sector which in its broader definition includes MMFs, investment funds and all other non-monetary financial institutions different from banks, insurance corporations and pension funds.

[12] Category "other" not shown

[13] IMF, Global Financial Stability Report, April 2016, p. 93

Chart 4: Shadow banking sector assets (Q1 1999 – Q4 2015; EUR trillions)



Source: ECB, Financial Stability Review, May 2016.

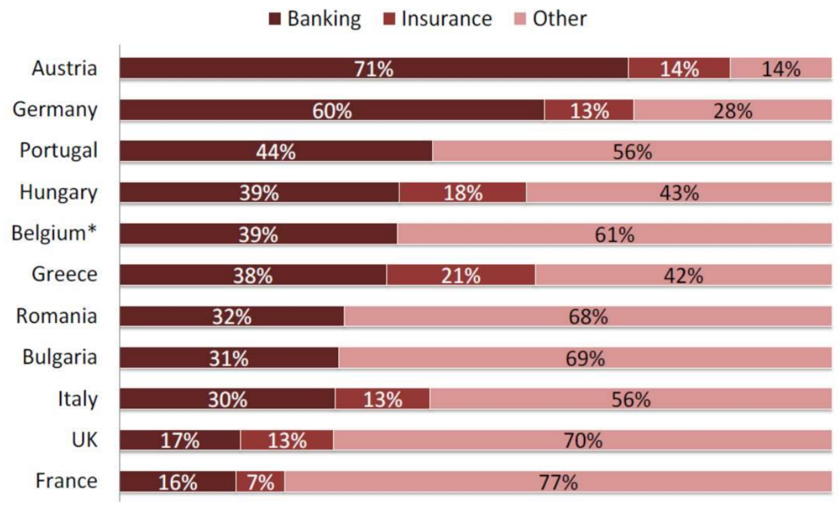
The expansion of this sector over the last 15 years has been remarkable, with two thirds of it driven by the part of the shadow banking for which no breakdown is available, which corresponds to a narrower definition of shadow banking, not including investment funds and MMF, but including securitization, broker/dealers, hedge funds, etc. This type of entities is increasingly engaging in risky liquidity transformation and credit intermediation. Overall, there appears to be a shift toward activities that are less well understood or monitored (for example direct corporate lending, peer-to-peer on-line landing platforms, derivative product companies and who therefore pose more risks for financial stability).

The continued expansion of finance outside the regulatory perimeter poses significant challenges for supervisors and regulators. There are concerns stemming from the opacity and complexity of large and diversified groups encompassing not only traditional (banking or insurance) institutions, but also shadow banking entities. An important source of concern is related to spillover effects as stress in the shadow banking sector may be transmitted to the rest of the financial system through ownership linkages, a flight to quality, and fire sales in the event of runs. In the context of large and complex groups as FICOs are, the risk that lending and other financial activities migrate towards those entities of the group which are not or are less regulated need to be carefully considered and handled in the context of a more comprehensive supervisory and regulatory framework. Currently, the only legislative framework at European level to address the need of a group comprehensive supervision is represented by FICOD.

The asset management industry has gained traction and linkages with other financial sectors have intensified

An important dimension of the European asset management industry from the point of view of this evaluation is the extent to which asset management firms operate as standalone companies, or form part of large and complex financial conglomerates. Such groups may consist of a mix of asset management firms, banks, and insurance companies. Chart 5 shows the relative importance of asset management companies belonging to a banking group or an insurance group. The companies that are independent or controlled by other types of financial firms are regrouped in the other category. In most European countries banking groups represent the dominant parent company of the asset management industry, controlling half or more of all asset management companies for example in Austria and Germany. Nevertheless, there are two big exceptions to this bank dominated model: the UK and France. In the UK, only 17% of asset managers are owned by banking groups, with insurance groups controlling 13%. In France, the majority of firms represent independent boutique asset managers (77%). Banks retain ownership of 16% of asset managers and insurance companies consist of 7% of asset managers in France.

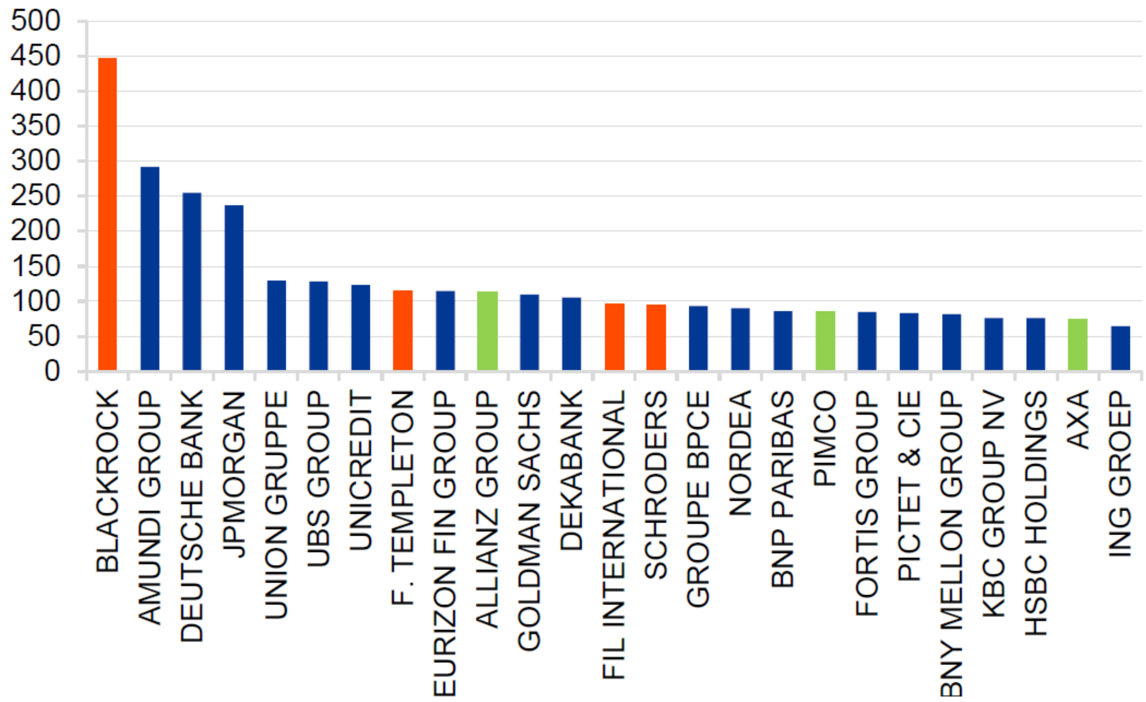
Chart 5: Number of asset management companies by parent group categories (end 2013)



(*) 39% for banking parent refers to banking/insurance parent company
Source: EFAMA, Asset Management in Europe, 8th Annual Review, April 2015.

Chart 6 shows that bank ownership is dominant for the top-25 management companies in the Euro Area. Chart 6 also shows the coincidence between the largest asset management companies in the Euro Area and the list of financial conglomerates as detailed in Annex 1.

Chart 6: Aggregate net assets of euro area funds managed by the top-25 management company parents and sector ownership (Q3 2015; total net assets in EUR billions)



Source: ECB, Financial Stability Review, May 2016.

Note: Asset managers are classified as held by banks/insurers when the asset manager is a subsidiary of the bank/insurer (this excludes cases where bank/insurance activities are a subordinate business of the group or where the holding company also holds banks/insurers) or has a bank/insurer as a majority shareholder

As bank ownership is prevalent among the largest asset management companies, there are concerns about step-in risk and contractual obligations of bank parent companies, that is the risk that the parent bank is required, contractually or by way of reputational pressure, to step in in cases where the asset management company gets into financial difficulties. Possible channels for contagion result from step-in risk, credit lines and contingency arrangements between banks, their asset management arms and the investment funds that they manage. In particular, euro areas banks, and, to a lesser extent insurers, have significant control over the euro area investment fund sector. According to ECB estimates[14], 52% (66 out of 127, accounting for 60% of total net assets) of euro area investment fund sponsors are either banks or owned by banks, while 16% (20 out of 127, accounting for 12% of total net assets) are either insurers or owned by an insurance company. Furthermore, bank and insurance ownership concentration increases with the size of asset managers.

Within the group of the 25 largest asset managers, only four managers are not directly affiliated with a bank or insurer and three out of those four are domiciled in the United States. Among them, the most relevant example is BlackRock which has recently risen to become one of the largest providers of intermediation services in securities lending. The role of the firm along the securities lending intermediation chain has progressively grown more complex. A large number of its investment funds contemplate the lending of their securities as an activity, and many do lend. The company also has multiple subsidiaries that provide agent lender services to the affiliated funds. In fact, one of these subsidiaries, Blackrock

[14] ECB, Financial Stability Review, May 2016.

Institutional Trust Company, is actually a non-depository bank[15]. The firm also owns a broker-dealer, Blackrock Investments, and it manages various families of hedge funds as well, thus potentially having a full presence on the demand side of securities lending transactions. Finally, the company is present in the reinvestment stage, where its agent lenders manage the cash collateral from the transactions of the company's many funds in pooled cash vehicles, also part of the organization. Hence, the company seems to have the scale and organizational scope to stretch beyond the core business model of an asset manager, and in fact, at least in the area of securities lending, the firm does not look very different from other top banking groups[16]. Not only BlackRock, but also other several asset managers hold a banking licence (Table 3). Sometimes, the banking licence is held at the level of the holding company (as in BlackRock), more frequently (as in the case of private equity groups Blackstone and KKR) the banking arm is a subsidiary of the group. In both cases, those players are involved in a multiple range of financial services. Such interconnectedness calls for an enhanced monitoring of potential systemic risks originating in or amplified by the investment fund sector.

Risks can also be posed by the interaction of financial and non-financial parts of a group.

Risks may also stem from sectors other than the financial one. Table 3 shows that among the non-bank non-insurance firms holding banks there are not only financial companies such as asset managers and private equity, but there can also be financial market utilities as well as industrial sector firms (automotive and utilities) or retail sector companies.

Table 3: Non-exclusive list of non-bank non-insurance firms holding banks

Company	*Sector*	*Country*
BlackRock	Asset management	US
Scottish Widows	Asset management	UK
Blackstone	Private equity	US
KKR	Private equity	US
LCH Clearnet	Clearing House	UK
Eurex	Derivatives Exchange	Germany
Toyota	Automotive	Japan
General Motors	Automotive	US
PSA	Automotive	France
Volkswagen	Automotive	Germany
Mercedes	Automotive	Germany
General Electric	Industrial	US
Tesco	Retail	UK
Sainsbury	Retail	UK
ICA AB	Retail	SE

Source: Commission Services' analysis using Orbis

[15] It is therefore subject to prudential regulation in the United States by the Office of the Comptroller of the Currency.
[16] Cetorelli, 2014.

The expansion into the financial sector of non-financial groups is not recent. Many large industrial corporations managed to exploit significant synergies internalising financial functions closely related to their core-business. For instance, the automotive sector is traditionally close to several financial business lines (e.g. insurance, car-loans, leasing, etc.). More recently, retailers entered the stage. For many firms, it is quite straightforward to explore the synergies arising from expanding in the financial sector. However, given the high fixed-cost incurred to enter it, only the larger firms are able to exploit this opportunity.

There is significant differentiation in the organisational structures of these groups which presents a high degree of complexity and variability. There is also the possibility that these trends got into reverse as for example is the case for General Electric. Through the years, a broad range of financial services activities have been internalized in the GE Capital subsidiary within the group. Up to 2013, the financial services division of General Electric provided almost half of the group’s earnings. In 2012 GE Capital acquired Metlife's banking business. The size of GE Capital means that it was one of only four non-bank businesses to be named as a Systemically Important Financial Institution by US regulators. The designation meant tighter regulation and higher capital requirements in a context of financial business increasing volatility. As a consequence, GE decided to sell most of its financial business. In two years, more than EUR 200 bn of assets have been sold. After the planned sale, GE Capital is expected to generate just 10 per cent of its profits. The future size of the division would depend on the returns it can generate subject to its regulatory constraints.

While financial conglomerates are by definition mainly active in the financial sector [Article 2 (14) in combination with Article 3 FICOD], those large complex industrial groups, although do not qualify as financial conglomerates, because of the non-financial part of their activity, may bear some risks, such as: i) the group relies heavily on financial earnings; ii) large exposure(s) with one investment/counterpart/region; iii) large intragroup exposures/transactions; iv) negative spill-over effects to the industrial part of the group.

2.4 State of play – implementation

Following the adoption of FICOD1 in 2011, Member States were subject to two transposition deadlines: 10/06/13 for the majority of the provisions and 22/07/13 for those provisions related to the inclusion of asset managers and alternative investment funds (AIFMs). 15 Member States were late in transposing FICOD1, and the majority of these cases related to transposition of the provisions related to asset managers and AIFMs. 16 infringement cases were opened by the Commission in relation to the transposition of FICOD1. These cases have since been resolved and complete and correct transposition has taken place in all Member States.

3 Methodology

The analysis in this Staff Working Document is based primarily on desk research of Commission Services and various stakeholder consultations. In particular, the Commission published a report in 2012 highlighting areas in which FICOD could be improved. The 2012 Report draws on the updated Joint Forum principles for the supervision of financial conglomerates and the Joint Committee of the ESA's sub-committee on financial conglomerates (JCFC) response to the Commissions' Call for Advice. This Staff Working Document draws on this report, as well as its underlying sources. This Staff Working Document also draws on feedback received regarding FICOD during the Commission's Call for Evidence exercise. Although there were a limited number of claims related to FICOD, those that did comment on FICOD specifically mentioned the need to consider whether the relevance and/or coherence of FICOD had changed given the changes in the sectorial legislation. Therefore this feedback was important in relation to this Staff Working Document. This Staff Working Document also considers the opinion received from the REFIT Platform. The opinion from the REFIT Platform recommended that the Commission review possible overlaps between FICOD and the sectorial legislation. This Staff Working Document explicitly considers whether there are overlaps between FICOD and the sectorial legislation in various places.

In addition to these sources, the Commission Services ran a public consultation to feed into the analysis. The public consultation ran from 09 June 2016 to 20 September 2016 (12 weeks). It focused on FICOD as a whole and split into sections which focus on the key measures of the Directive: the identification of captured entities; risk management in financial conglomerates; supervision and enforcement. This Staff Working Document is also structured in this same way.

Due to the technical nature of the FICOD capital adequacy requirements, the Commission Services undertook separate and targeted roundtables with experts in the Commission Expert Group on Banking, Insurance and Payments (CEGBPI) and consultation with supervisory experts through the ESAs joint committee's sub-committee on financial conglomerates (JCFC). The responses to this engagement have been incorporated into the section on capital in this Staff Working Document.

3.1 Limitations – robustness of findings

It should be noted that at the time of adoption of the original FICOD in 2002, no impact assessment was carried out. This has limited the ability for Commission Services to include baseline data in this Staff Working Document. Additionally, due to the fact that FICOD focusses on setting up a supervisory framework for the oversight of financial conglomerates which did not exist before, it has generally been difficult to *quantify* the impacts of the Directive. This is particularly the case as regards the incremental cost resulting from the supplementary supervisory measures arising from FICOD as compared to those set out in sectorial legislation. The Commission Services did not receive any quantitative data in response to the public consultation in 2016. In particular, stakeholders did not provide the Commission Services with any examples of failures of financial institutions which could have been perceived as due to the weaknesses in FICOD provisions. The Commission has also not received any complaints related to the implementation of FICOD. Due to all these factors there is an overall lack of quantitative evidence on the effectiveness of the Directive. Additionally, there are very limited external studies assessing the quantitative impact of FICOD specifically. Commission Services have used one study which specifically considers the cost of complying with FICOD, but in general external studies of this kind do not exist. While the cost of rerunning a study of this kind far exceeded the scope of this exercise, in the context of the Fitness Check on regulatory reporting about to be launched by Commission services this year, an updated study of this kind is likely to be undertaken in order to assess the cumulative cost of reporting duties for financial institutions.

3.2 Costs to industry of FICOD

Although responses to the Commission Services' public consultation did not provide with quantitative data on the costs of compliance with FICOD, there has been some analysis conducted on the compliance costs of various European Directives. A 2009 study by Europe Economics looked at the costs of six main European Directives.[17] Tables 4 and 5 below set out Europe Economics' findings on the mean one-off and ongoing costs of complying with these directives. Ongoing costs include information gathering for the calculation of capital adequacy, internal monitoring and external reporting on risk concentrations, while one-off costs relate in large part to investment in IT and the re-shaping of business processes. As the tables below show, FICOD was not an important driver of costs amongst the selected Directives and participants to the study did not see it as a significant cause of regulatory-driven increase in costs.

Table 4: Mean one-off costs of the Selected Directives (expressed as a percentage of 2007 operating expenses)

	Banks & Financial conglomerates	Asset Managers	Investment Banks	Financial Markets
Prospectus	0.02%	0.05%	0.00%	0.67%
FICOD	0.01%	0.01%	0.00%	0.00%
CRDs	1.53%	0.46%	1.37%	0.00%
Transparency	0.03%	0.22%	0.01%	0.44%
MiFID	0.52%	0.48%	0.52%	1.46%
3AMLD	0.29%	0.21%	0.23%	0.16%
Total	**2.41%**	**1.43%**	**2.14%**	**2.74%**

Source: Europe Economics, (2009), Study on the Cost of Compliance with Selected FSAP Measures

Table 5: Mean on-going costs of the Selected Directives (as expressed as a percentage of 2007 operating expenses.

	Banks & Financial conglomerates	Asset Managers	Investment Banks	Financial Markets
Prospectus	0.01%	0.16%	0.01%	-0.15%
FICOD	0.00%	0.01%	0.00%	0.00%

[17] The Capital Requirements Directives (the CRDs); the Transparency Directive; the Markets in Financial Instruments Directive (MiFID); the Third Anti-Money Laundering Directive (3AMLD); the Prospectus Directive and the Financial Conglomerates Directive

CRDs	0.23%	0.06%	0.14%	0.00%
Transparency	0.01%	0.08%	0.03%	0.33%
MiFID	0.10%	0.30%	0.08%	1.09%
3AMLD	0.08%	0.07%	0.05%	0.13%
Total	**0.43%**	**0.68%**	**0.32%**	**1.41%**

Source: Europe Economics, (2009), Study on the Cost of Compliance with Selected FSAP Measures

Europe Economics' analysis also looked at the drivers of the one-off compliance costs (Table 6). The study suggests that for FICOD, the cost comes mostly from the need to update and invest in IT systems. This implies that following an initial set-up cost, extracting the data does not represent a significant driver of costs for financial institutions.

Table 6: The cost drivers of the Selected Directives

Directive	**Prospectus**	**FICOD**	**CRDs**	**Transparency**	**MiFID**	**3AMLD**
Familiarisation with Directive	49%	15%	2%	13%	3%	3%
Consultancy fees	5%	11%	20%	5%	13%	11%
Legal advice	23%	5%	5%	5%	7%	1%
Training	13%	8%	5%	11%	15%	22%
Staff recruitment costs	0%	2%	4%	1%	2%	2%
Investment in/updating IT	2%	47%	57%	63%	52%	54%
Project management	8%	9%	8%	3%	7%	7%
Other	0%	2%	0%	0%	0%	0%

Source: Europe Economics, (2009), Study on the Cost of Compliance with Selected FSAP Measures

These findings suggest that, as regards efficiency, FICOD does not pose significant issues, as the costs related to its implementation are not relevant for supervised groups. This is confirmed by the fact that respondents in the industry did not raise nor quantified the issue. In addition to this, recent studies[18] on the costs of regulatory compliance for financial firms do not mention FICOD as a source of costs.

Further evidence supporting this conclusion lies with the impact assessment performed by the ESAs when they issued the joint guidelines on 22 December 2014 on the convergence of supervisory practices relating to the consistency of supervisory coordination arrangements for financial conglomerates[19]. The issuance of the guidelines follows Article 11 of the FICOD

[18] Thomson Reuters, 2016, Cost of compliance; D.Elliott, S.Salloy, A.Santos, 2012, Assessing the Cost of Financial Regulation, IMF Working Paper 12/233; Deloitte University Press, 2015, Global risk management survey, ninth edition; ECB, 2015, The impact of the CRR and CRD IV on bank financing, Eurosystem response to the DG FISMA consultation paper.

[19] ESMA, EBA, EIOPA, JC/GL/2014/01, 22 December 2014

Directive. The impact assessment accompanying the joint guidelines does not find evidence of significant costs for competent authorities nor for financial groups.

In response to DG FISMA's public consultation competent authorities indicated that the main direct cost will relate to establishing processes for compliance with the proposals of these guidelines. Such costs will be driven mainly by the need to adapt existing processes, or implement new processes for coordination, communication and information exchange with other competent authorities, and monitoring compliance with these guidelines. Further costs might include costs for training existing staff, hiring additional staff, if necessary, and related travel and reimbursement costs. However, these costs, even if not quantified, are assumed to be not significant.

On the basis of this feedback, as for financial institutions, no significant costs are expected. There may be costs related to setting up processes for the disclosure of necessary information and evidence to the competent authorities, and costs resulting from requests for information made by the coordinator and competent authorities. Also in this case, even if not quantified, costs are assumed to be not significant.

Considering that:

i) the ESAs' impact assessment refer to the end of 2014
ii) the joint guidelines have been issued following the quick fix of FICOD

we can conclude that, beyond the one-off costs for the initial compliance with the Directive which are highlighted in the Europe Economics Survey already mentioned, the on-going costs of implementing FICOD have not changed significantly in the years following the study publication (2009) and can overall be considered not significant in comparison with compliance costs deriving from other banking and insurance regulations.

5 Analysis

This section of the Staff Working Document covers the Commission Services' analysis of FICOD. It covers each of the main "building blocks" of FICOD separately: the identification of financial conglomerates; the capital calculation under FICOD; the governance provisions; the rules on intra-group transactions and risk concentration; and the supervisory and enforcement framework set out by FICOD. The EU-added value of FICOD is dealt with firstly and transversally as this covers an assessment of the FICOD provisions as a whole, rather than by provision.

4.1 EU-Added value

FICOD was developed to address the specific lack of EU-wide framework for the supervision of financial conglomerates – that is groups which are active in two or more financial sectors (namely banking and insurance). Different financial activities are regulated by their own sectorial frameworks, but FICOD introduced a combined approach to specifically address the cross-sector risks in these groups. Since its adoption, sectorial frameworks have not aimed to achieve the same result and FICOD remains the only piece of legislation that focuses on this angle. To this extent, FICOD continues to have EU added-value beyond what is achieved at the sectorial level. If discontinued, risks could arise for financial stability and investor protection.

Additionally, many of the financial conglomerates identified operated across borders and as such the development of an EU-wide framework for the supplementary supervision of these groups goes beyond what would be possible to achieve at Member State level. This view was confirmed by respondents to the Commission Services' public consultation. Specifically, the enhanced supervisory cooperation required by FICOD was mentioned by respondents as a key area in which FICOD provides added-value beyond the sectorial frameworks.

4.2 Further analysis of specific FICOD provisions

4.2.1 Identification of financial conglomerates

4.2.1.1 State of play

FICOD identifies financial conglomerates as groups with at least one entity in the insurance sector and at least one entity in the banking/investment sector. The group must carry out significant activities in both financial sectors. It should be noted that although asset management is included broadly in the scope of FICOD, the focus on the bancassurance model may exclude the full range of business models in the market.

FICOD then sets out quantitative thresholds to establish the significance of the activities in the group. The second step in identifying which financial conglomerates to include within the scope of FICOD is comprised of quantitative thresholds, as detailed in section 2.2.

FICOD currently allows supervisory authorities to decide to waive the requirements of FICOD where applying supplementary supervision is not necessary, is inappropriate or would be misleading with respect to the objectives of supplementary supervision. These waivers can be granted where a group meets only one of Threshold 2 and Threshold 3 outlined above.

Article 3 of FICOD also allows supervisory authorities to replace the balance sheet metric in thresholds 1 and 2 with alternative parameters (income structure, off-balance sheet activities, total assets under management) if they are of the opinion that these parameters are of particular relevance for the exercise of supplementary supervision.

It is noted that regulated entities active in the financial markets such as ancillary insurance service undertakings or pension funds are not currently within scope. Similarly, special purpose entities, which under certain circumstances may be covered by sectorial financial legislation, are not explicitly covered by FICOD. Moreover, it may be important to consider the activities of unregulated entities. Currently mixed financial holding companies, which are defined as the parent company of a financial conglomerate, are included within the scope of the Directive. However, other unregulated, non-financial entities (mixed activity holding companies; firms financial technology firms; firms providing similar services to regulated entities; and industrial firms) within a financial conglomerate are not captured, considered or monitored under FICOD.

4.2.1.2 Analysis

Effectiveness

When assessing how effective FICOD has been in achieving its objectives, it is important to consider whether the Directive identifies the right risks in a financial conglomerate. Key to this is whether supervisors are able to capture the right groups (and entities within those groups), as well as the right activities. The **effectiveness** of FICOD in achieving its objective of addressing the specific prudential risks in financial conglomerates requires that it captures the groups for which these risks are the most significant.

The ability of FICOD to capture the right groups is a consequence of the way in which the thresholds in the Directive operate. The quantitative thresholds were designed to be clear and transparent, and to provide predictability as to the groups that would be subject to FICOD. However, a consequence of this is that there is little flexibility afforded to supervisory authorities – except to exclude groups that are captured under only two of the thresholds. Using mechanistic formulas may mean that groups for which supplementary supervision would be appropriate end out of the scope of supervision, while other groups for which the supervision is not needed may instead end up being supervised. In the latter case, the supervisory authority can chose to exercise their right to a waiver; however in the former case there is no mechanism for supervisory discretion despite potential concerns over the risk profile of these groups. It should be noted, however, that in response to our public consultation some respondents argue that there is already too much supervisory discretion in the application of the thresholds, as the use of waivers and alternate metrics (as allowed under FICOD) may lead to different decisions across supervisory authorities. This discretion also undermines the **effectiveness** of FICOD in identifying the right groups that should be subject to supplementary supervision as it may mean the provisions are not applied consistently.

Related to this is how **effective** the thresholds are overall in their mechanics for identifying the correct groups. In addition to the issue highlighted above, there are more specific issues related to the metrics used in the thresholds. The thresholds were developed in the original FICOD and have not been revised since, and therefore may not reflect a risk-based approach that was developed after the crisis. In particular, the balance sheet total in threshold 3 is not a risk sensitive measure nor can it capture cross sectorial activities. In this response to our public consultation, many respondents highlighted that the methodology for calculating thresholds when asset managers and alternative investment fund managers are within the group is unclear and not transparent. The current threshold rules could therefore lead to some groups being deliberately structured in such way as to avoid the consequences of being classified as a financial conglomerate, and therefore avoiding supplementary supervision. There have been limited cases of this happening reported to the Commission Services during the course of the consultation.

The balance sheet figure is also difficult to interpret because FICOD does not specify what accounting standards should be used to calculate this figure – IFRS or national GAAP. This may mean a lack of level playing field across Member States, thus undermining the **effectiveness** of the identification process. Additionally, the thresholds currently do not reflect the size of the market where each conglomerate operates so they do not reflect the relative importance of entities compared to their markets, which may further undermine the **effectiveness** of the identification process.

Another consideration in relation to the identification of groups under FICOD is the use of waivers by supervisory authorities. As mentioned above, in the case that a group meets only one of threshold test 2 or 3, a supervisory authority can choose to waive the requirements of FICOD if they deem it inappropriate to apply them. Currently, around a third of the identified financial conglomerates benefit from this type of waiver[20]. In addition to this waiver, there are also waivers which allow the use of alternative metrics in the thresholds, as detailed above. There is no collection of data on the use of this type of waiver. The use of these waivers may undermine the **effectiveness** of FICOD in identifying the correct groups to address supplementary supervision towards as there are no harmonised rules detailing the process for granting these waivers. Therefore the element of national discretion in this process could lead to a lack of uniformity in how waivers are granted across Member States. This could undermine the ability of FICOD to create a sound framework for supplementary supervision of cross-border entities. However, the fact that the SSM is now the coordinator for a number of the banking-led conglomerates may minimise this lack of uniformity as the decision will be

[20] https://esas-joint-committee.europa.eu/Publications/Guidelines/JC%202016%2077%20%28List%20of%20identified%20Financial%20Conglomerates%202016%29.pdf

taken consistently within the SSM. Nevertheless, a number of financial conglomerates remain outside of the scope of supervision by the SSM and so the issue still remains[21].

Another key issue in the scope of FICOD is whether supervisors are able to capture the ultimate responsible entity – that is the entity ultimately responsible for the group regulatory compliance. FICOD does not designate a single point of entry for supervisory intervention, where policies, strategies and decisions relevant for the whole group are effectively taken and with clear assignment of responsibility for compliance in respect of supplementary supervision. An inability to address the ultimate responsible entity may undermine the **effectiveness** of FICOD as it means it may be difficult to enforce against the entity in control of the group. This may be particularly difficult where the head of group is a holding company that is a not a regulated entity. Supervision applied at this level remains essential to ensure that NCAs have access to, and can hold accountable, the ultimate controllers of financial businesses.

FICOD defines MFHCs as the parent company of a financial conglomerate, which is not a regulated entity. However, there are limited powers defined in the Directive over these companies, which can make it difficult for supervisory authorities to properly supervise the head of the group. The majority of respondents to our public consultation did not consider the definition of MFHC itself be clear and in line with market developments. Only a few respondents were not concerned by the lack of powers provided by FICOD in relation to MFHCs. These responses came from Member States that have national legislation in place which enables the NCAs to designate a MFHC as the entity that is responsible for capital adequacy of the group and conferring on them direct powers over these holding companies.

In addition to MFHC, there may be a mixed activity holding company (MAHC) that holds a financial conglomerate. MAHC are defined under both CRD/CRR and Solvency II, and are holding companies which hold financial entities but whose business is predominantly non-financial. The boundary between a mixed financial holding company and a mixed activity holding company is determined by size metrics which are open to judgement and amendment rather than being determined by, for instance, the potential effect that the failure at the level of a particular holding company may have on financial stability. The identification of an entity as a mixed financial holding company or a mixed activity holding company may affect the supervisory tools available to the competent authority. Additionally, the **effectiveness** of FICOD may be undermined by this distinction between MFHC and MAHC, because, the fact that at group level, the financial business is diluted by non-financial activities, does not mean the ultimate parent will not make decisions relevant to regulated entities or exert pressure on its regulated subsidiaries.

[21] The SSM supervises significant banking institutions in the Euro area. Those financial conglomerates located outside of the Euro area, or whose character is predominantly insurance-based will not be captured in the supervisory scope of the SSM.

Efficiency

The application of the thresholds also has implications for the efficiency of FICOD in meeting its objective of addressing the specific prudential risk posed by financial conglomerates. In order to be efficient, the system of applying the thresholds should be simple to apply, whilst at the same time ensuring that the correct groups are identified. The application of mechanistic process based on quantitative thresholds and formulas may make the identification less burdensome for supervisors as it provides a clear framework for identification of those groups to be subject to FICOD. The alternative of granting more discretionary powers, risks being not only too discretional with consequent wide differences across jurisdictions, but also too burdensome as a more elaborate system of supervisory judgement would have to be developed. However, the application of mechanistic thresholds itself could be seen as too burdensome as it is still time consuming to apply the metrics and, at the same time, the identification process may still leave out groups that should be under the scope and vice versa. In response to our public consultation, some supervisors also highlighted that the process is made more costly as the figures cannot be taken directly from the group's financial statements, but have to be requested from the group. This is detrimental in terms of transparency and especially efficiency. Therefore supervisory authorities are bound by a process which takes time and resource, without necessarily producing an appropriate outcome.

The scope of FICOD may also have implications for efficiency in terms of the regulatory burden of covering all the relevant entities. Gruson (2004) observes that the range of entities listed in Article 5 of FICOD implies a huge administrative reporting burden, the supervisory effectiveness of which may be questionable. However, in response to the Commission Services' public consultation, the industry did not indicate an undue regulatory burden in this respect.

Relevance

A key consideration on the relevance of FICOD is to consider how effectively it captures risks in the current market context. In order to be **relevant**, the provisions must continue to capture the risks most significant in the market place now. When FICOD was adopted in 2002, the most prominent mixed financial activity groups were "bancassurers' – those groups that combine banking and insurance business. This business model remains relevant in the European market; however there have been developments that have led to a growth in the other types of mixed-activity financial groups. As detailed in the introductory sections, there is a trend not only across the EU, but also at global level, towards a greater variety of operating models among these mixed activity groups. For example, insurers expand into securities activities and asset managers expand into the area of banking. Other financial sectors beyond banking and insurance have gained prominence in recent years, for example the asset management industry and the shadow banking sector. In addition, a significant number of non-banking or even non-financial groups own banks. The academic literature confirms that FICOD does not sufficiently capture certain group structures. De Vuyst (2010 p.

314 et seq.) observes that the entities subject to the requirements of the Directive as described in Article 5 may not cover all possible group structures.

The potential synergies and vulnerabilities arising between asset managers and their banking and securities activities could be substantially different from those of the bancassurance model. Asset management and securities activities can indeed give rise to significant synergies and economies of scale and scope[22], but, at the same time, the fragility of the group to multiple sources of risk may increase[23]. The diversity between asset management and banking/insurance business may mean the integration of these business models could result more difficult to manage for the financial conglomerate, and harder for the supervisors to understand.

At the same time, banks and insurance companies are major owners of asset management companies (cf. section 3.3) and the overall stability implications of these arrangements are unclear. Without proper oversight of related-party exposures and concentrated exposures, funds could be used as funding vehicles for their asset management company's parent banks. These interrelationships of financial services providers across various sub-segments of the financial sector create very influential and complex mega conglomerates.

FICOD was not designed to take account of these changing structures, as its focus has remained on the bancassurance model. FICOD may not, therefore, enable the supervisor to capture also those groups where traditional financial regulated entities mix with new, so far unregulated ones which may undermine the **relevance** of FICOD.

There are also issues with the **relevance** of the 6 billion EUR threshold used for identifying the financial conglomerates to be subject to the provision in FICOD, as the effect of inflation and market developments have not been taken into account in this number, meaning that the relevance of this figure for identifying significance is diminished.

Coherence

FICOD was developed to address the lack of a specific prudential regime for financial conglomerates. Since its adoption, an alternative regime for these groups has not been developed through any other means. However, in our public consultation several stakeholders raised an issue with the **coherence** of the identification process in FICOD and, in particular, with the different definitions of groups and participations existing in FICOD and in other pieces of EU legislation (CRR, BRRD and Solvency II). There may also be an issue with the coherence in the application of the waivers. A couple of respondents brought the example of

[22] Kashyap, Rajan, and Stein (2002); Gatev and Strahan (2006); The Institute of International Finance (2010); Frontier Economics (2013), Diamond (1991), Rajan (1992), Saunders and Walter (1994), Drucker and Puri (2005).

[23] Bhattacharya, Boot, and Thakor, (1998); Kroszner and Rajan (1994); Johnson and Marietta-Westberg (2009); Fecht et al. (2010); Klein & Saidenberg (2010); Flannery et al. (2010); Gulamhussen et al. (2012); De Nicoló et al. (2004); Stiroh and Rumble (2006); Lepetit et al. (2007); Wagner (2010); De Nicoló and Kwast (2002); Baele et al. (2007); Brunnermeier et al. (2012); Kay (2012).

an institution that could be deemed significant under SSR and not significant for FICOD purposes.

4.2.2 Capital requirements in FICOD

4.2.2.1 State of Play

Article 6 of FICOD requires Member States to ensure that regulated entities have in place adequate capital adequacy policies at the level of the financial conglomerate, and requires supervisors to check the capital adequacy of a conglomerate. The methods for calculating capital adequacy defined in Annex I of FICOD aim at ensuring that multiple use of capital is avoided. The purpose of the FICOD capital calculation is to achieve the objective of addressing the specific prudential risks present in financial conglomerates.

Annex I of FICOD sets out three methods for the calculation of capital adequacy of a financial conglomerate. The purpose of the calculation is to ensure that there is adequate capital at the level of the financial conglomerate. FICOD does this by requiring a calculation to ensure that the total level of capital (own funds) exceeds the total of all capital requirements at the level of the financial conglomerate. What FICOD does not do is impose an additional binding requirement at the level of the financial conglomerate on top of the combination of sectorial requirements. From an own funds perspective, FICOD focuses on *surplus* own funds – that is own funds over and above what is required by sectorial requirements.

<u>Method 1: Accounting consolidation method</u>

Method 1 calculates the capital adequacy requirements on the basis on consolidated accounts. This means one balance sheet is compiled for the group.

The use of 'consolidated accounts' eliminates all own funds' intra-group items, in order to avoid double counting of capital instruments. According to the Directive provisions, the eligibility rules are those included in sectorial provisions.

<u>Method 2: Deduction and aggregation method</u>

This method calculates the supplementary capital adequacy requirements of a conglomerate based on the accounts of solo entities. It aggregates the own funds and capital requirements of the solo entities. All intra-group creation of own funds shall be eliminated.

<u>Method 3: Combination of methods 1 and 2</u>

The use of combination of accounting consolidation method 1 and deduction and aggregation method 2 is limited to the cases where the use of either method 1 or method 2 would not be appropriate and is subject to the permission of the competent authorities.

4.2.2.2 Analysis

Effectiveness

Overall, respondents to our public consultation felt that having a group-wide view of the capital position of a financial conglomerate is a useful supervisory tool. However, there may be a lack of clarity in the rules – for example because the language in the Annex is relatively high level, without explicit details on the methods. This lack of detail was attempted to be addressed through the Delegated Regulation. However, many respondents to the Commission Services' public consultation, particularly from supervisory authorities, highlighted that the drafting in the DR still lacks clarity and the level of detail required to promote harmonisation of the methods across Member States.

Therefore the lack of clarity and the fact that several changes have taken place at the sectorial level which makes the interaction between FICOD and the sectorial rules a complex matter, may undermine the **effectiveness** of the capital provisions in FICOD in ensuring prudential risks are properly covered by the FICOD regime. The lack of clarity on how to properly apply the capital calculations mean that there may be differing approaches across Member States and this lack of harmonisation undermines the effectiveness of the provisions in developing a sound and coherent supervisory framework for financial conglomerates.

There is also an issue of **effectiveness** because the FICOD capital calculations operate in a way that essentially means they are a *summing* of the sectorial requirements. They do not explicitly allow supervisors to require extra capital to be held at the level of the financial conglomerate to cover cross-sectorial risks (a Pillar 2-style requirement[24]). This lack of specific consideration of cross-sectorial risks in the setting of the financial conglomerate capital requirement may undermine the effectiveness of FICOD in addressing the specific prudential risks in financial conglomerates. In response to our consultation, many supervisory respondents mentioned that the Pillar 2 requirements under CRD/CRR and the capital add-on requirements in Solvency II do, in fact, allow supervisors to require additional capital for these cross-sectorial risks at the sectorial level. Other supervisory authorities argue that this is not the case. In particular, some respondents claim that the use of the Solvency II add on for this purpose is not straight forward – in particular because the conditions of its use under Solvency II refers only to those risks that deviate from the Standard Formula of Solvency II. Those respondents consider that it could be hard to argue that risks arising from other financial sectors really fall into this category. It may be that the lack of a capital add on regime at financial conglomerate level creates an uneven playing field between banking supervisors and insurance supervisors. Other supervisory respondents argued that in order to be equipped for a crisis situation, it may be useful to allow supervisors to require additional capital at the financial conglomerate level for risks not covered by the sectorial requirements and to be able to require additional capital to avoid regulatory arbitrage, particularly where risks are treated differently under the banking rules and the insurance rules.

[24] CRDIV contains provisions which allow supervisory authorities to impose a wide range of measures - including additional capital requirements – on individual institutions or groups of institutions in order to address higher-than-normal risk.

Some respondents highlight that Article 16 of FICOD, on enforcement measures, is drafted broadly enough to allow supervisors to require additional capital at financial conglomerate level. However, some respondents to the Commission Services' public consultation consider that the provision is broadly drafted and may not explicit enough to ensure that supervisors feel they are empowered to require this additional capital under the FICOD regime. This undermines the **effectiveness** of the FICOD provisions, because it undermines the creation of a sound supervisory framework for financial conglomerates by leaving ambiguity in the supervisory powers available in the Directive.

Related to this issue of enforcement, is the fact that it is not always clear what enforcement actions should be taken in case that the result of the FICOD capital calculation is negative. Although FICOD requires that the capital calculation at financial conglomerate level must be positive, it does not detail what actions should be taken if this is not the case. In particular, this is relevant given that the sectorial regimes have more detailed ladders of supervisory intervention that kick-in at various points on a breach. This is relevant for the buffer provisions under CRD/CRR and also the rules around distributions under the Maximum Distributable Amount (MDA). Respondents to our public consultation also highlighted this issue of enforcement, and in particular the fact that FICOD is silent on how constraining the FICOD capital requirements should be considered to be. By not being clear on the effects of a breach of the requirements, the **effectiveness** of a sound supervisory framework for financial conglomerates may be undermined.

Efficiency

In terms of **efficiency** of the FICOD capital requirements, the biggest issue raised by respondents to the Commission Services' public consultation was the fact that there are no harmonised templates for the reporting of the capital calculation, or for the disclosure of the financial conglomerate capital ratio as required by CRR. The lack of harmonised reporting and disclosure hampers the comparability of the application of the capital calculations across Member States. This added to the fact that the clarity of the calculations is not clear to begin with, may hamper the **efficiency** of FICOD to ensure that adequate capital is held at the financial conglomerate level.

Relevance

It is also important to assess the **relevance** of the capital calculations in FICOD, given the changes that have taken place at the sectorial level. This is particularly important when considering insurance-led conglomerates and the new Solvency II group calculations. Specifically, the inclusion of 'other financial entities' in the Solvency II group capital calculation will already cover banking entities in insurance-led conglomerates, reducing the relevance and added-value of the FICOD calculation for these groups. Indeed, the DR on capital calculations already clarifies that Method 1 of FICOD and Method 1 of Solvency II should be considered equivalent. Therefore it is clear that the **relevance** of FICOD for insurance-led conglomerates who are applying Method 1 under Solvency II is diminished.

Coherence

There are a number of issues related to the **coherence** of FICOD and the sectorial requirements in the area of the capital adequacy calculations.

Firstly, the development of Solvency II has had a large impact on the **coherence** of the application of Method 1 – accounting consolidation – of the FICOD capital calculations. Solvency II introduces a new valuation method, meaning all assets and liabilities must be valued according to the Solvency II rules (at fair value) which may be different to the valuation method used for the purposes of the accounting consolidation under IFRS, which is the basis for the calculation of the banking part of financial conglomerate. The DR on the FICOD capital calculations makes clear that for the purpose of the FICOD calculation insurance assets should now be valued according to the Solvency II framework. Respondents to our public consultation mentioned that it is not clear how a set of consolidated accounts for the purposes of Method 1 can be compiled when the banking and insurance assets are valued on a different basis.

There are also issues with the **coherence** between FICOD and CRR. Under the CRR, banking groups are required to deduct their holdings in insurance undertakings. The intention of this provision is aimed at ensuring that a bank is not permitted to count in its own funds the capital used by an insurance subsidiary. This is in line with the Basel III treatment. The approach of deduction may act as an incentive to capitalise insurance subsidiaries as minimally as possible to avoid a large deduction at the banking group level. It was for this reason that the CRR also contains an alternative approach which allows banking groups not to deduct their holdings in insurance subsidiaries and instead to risk-weight these holdings, provided that group is subject to the more risk sensitive consolidation approach under FICOD (Article 49 CRR). This is due to the fact that the in the EU, the Commission had the responsibility to ensure that adequate capitalisation of both banking and insurance sectors, and the risk-weighting approach helps mitigate the risk of under-capitalisation of insurance subsidiaries that could be posed by the deduction approach. In addition the European regulation had via FICOD a tool that enabled to restrict the "double counting" of capital – the main rationale for the deduction of large investments in insurance.

In relation to the above issue, one respondent to the public consultation raised an issue of **coherence** of the FICOD and the CRR. This point was raised repeatedly by this respondent. The argument is that because of the inclusion of mixed financial holding companies in the scope of the CRR, financial conglomerates that are predominantly insurance-led are required to apply the CRR capital calculations at the consolidated level. This may be inappropriate as the two options proposed in the CRR – either the deduction approach or the risk-weighting alternative – either produce a too severe or too lenient capital result respectively. CRDIV and Solvency II both contain provisions which allow supervisors to apply *only* the FICOD to the mixed financial holding company where it is subject to equivalent supervision under CRDIV/Solvency II and FICOD. This avoids the inappropriate or duplicative application of CRDIV/Solvency II and FICOD to the mixed financial holding company, if appropriate. On this issue the respondent argues that the fact that there is no such provision in the CRR creates **coherence** issues.

Another issue in the **coherence** between the sectorial legislation and the FICOD calculation is how to include any capital add-ons or buffers applied at the sectorial level in the capital requirement at financial conglomerate level. Due to the fact that FICOD was adopted before these sectorial developments, FICOD is silent on this issue. In the DR on capital calculations it is clarified that these additional requirements should be considered as part of the sectorial solvency requirements to be aggregated at the financial conglomerate level. However, what is not clear is how this would work in practice given that the add-ons and buffer requirements serve a different purpose to the basic capital requirements, and therefore have different consequences in terms of supervisory actions on a breach. Additionally, the buffer requirements under CRD/CRR have to be met with a specific quality of capital, namely CET1 capital. In insurance-led conglomerates this could create problems because it is not clear whether Solvency II Tier 1 capital would be an acceptable substitute for banking CET1 given the differences in approaches to quality of capital under each of the sectorial regimes. There is a problem with coherence of this approach at the sectorial level, and the approach at the financial conglomerate level.

The DR on capital calculations also introduced the concept of a transferability assessment for own funds at the financial conglomerate level. This means that surplus own funds can only be included at the financial conglomerate level if there is no foreseen practical or legal impediment to the transfer of funds between entities in the financial conglomerate. Solvency II also contains a transferability assessment for own funds at group level, which is more detailed and precise than the one available under FICOD. Because the DR was adopted prior to the adoption of the final Solvency II implementing provisions, it is not clear how these two assessments should interact, thus calling into question the **coherence** of these provisions.

There are a number of issues related to the interaction between the transferability assessments in Solvency II and FICOD. Firstly, it is not clear to what extent the Solvency II assessment can be relied upon for FICOD purposes. Because the DR makes explicit reference to the fact that the transferability assessment should consider the transferability *between* sectors; therefore implying that it must be an additional assessment in addition to the Solvency II assessment which mainly considers transferability between insurance entities.

The changes in the sectorial regimes also give rise to **coherence** issues because of the introduction at the sectorial level of the concept of tiering of capital. Under both CRD/CRR and Solvency II there a limits to the use of each tier of capital, and what capital requires they can be used to cover (for example buffers etc.). However, FICOD is silent on how any additional tiering limits may apply at the financial conglomerate level. Given the differences in the regimes for classifying the quality of capital in the sectorial legislation, some supervisory respondents to the public consultation had doubts how a tiering restriction could be applied at financial conglomerate level and consider that the sectorial regimes cannot simply be applied upwards. This is particularly relevant also for meeting the buffers at financial conglomerate level, as described above.

4.2.3 Governance

4.2.3.1 State of play

Governance generally refers to a range of policies which cover how an entity or group is controlled and directed. It concerns the relationships between the management and stakeholders of the group and also the structure of how the group is organised and managed. Good governance ultimately ensures appropriate management of risks in a group and should also ensure compliance with the rules on a financial conglomerate basis. Given the complexity involved in these groups and their cross-sectorial character, there may be conflicts of interest. Good governance should include strategies that balance and consider these varied interests and ensure that group or conglomerate strategies are not detrimental to different parts of the conglomerate or the conglomerate as a whole.

FICOD requires financial conglomerates to have sound risk management and internal control mechanisms in place to ensure that risk monitoring systems are well integrated into the organisation and sound reporting and accounting procedures. There is also a "fit and proper" requirement for persons who effectively direct the business of the financial conglomerate (they must be of sufficiently good repute and have sufficient experience to perform relevant duties). FICOD also requires financial conglomerates to submit information on their legal structure and governance and organisational structure to the competent authority, as well as to publish this information annually.

At the time FICOD was adopted in 2002, the governance provisions applicable at the sectorial level for both banking and insurance were limited. For banks, the applicable framework was the original CRD[25] which required credit institutions to have sound administrative and accounting procedures, and adequate internal control mechanisms, but did not specify these and left the definition of more detailed rules to Member States. The picture was much the same in the insurance sector, where regulation remained patchy – governed by a number of different Directives[26].

4.2.3.2 Analysis

Effectiveness

One key development in policy making in relation to governance is the emphasis on the importance of resolution and resolvability of groups. This has been most significant in the area of banking with the adoption of the Banking Resolution and Recovery Directive (BRRD), given that banks were at the centre of the crisis. On the insurance side, this thinking is less developed so far. This is important in a financial conglomerate context, where the groups combine at least both banking and insurance business, and where there is a lack of

[25] Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions

[26] Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance
First Council Directive 73/239/EEC of 24 July 1973 on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance

harmonised approach. It is important to consider whether this has undermined the **effectiveness** of FICOD in ensuring the financial stability of these groups.

In response to the public consultation, supervisory respondents mainly argued that it would be premature to consider any resolution framework for financial conglomerates while there is a gap in this area on the insurance side. Additionally, many respondents highlighted that the development of robust sectorial regimes would be sufficient in ensuring a sound resolution framework for groups, including financial conglomerates.

The **effectiveness** of FICOD to ensure the financial stability of financial conglomerates may be undermined by its silence in the area of resolution, and in particular the fact that FICOD is silent on the cooperation between resolution authorities and competent authorities. Due to the fact that FICOD was adopted well before the development of the resolution framework, it does not contain any specific provisions related to the cooperation between these authorities when handling the crisis management of financial conglomerates.

Another aspect of the current FICOD provisions where the effectiveness may be undermined in a resolution context is the lack of details on how supervisors of financial conglomerates should assess group structures. As detailed in section 2, 3, financial conglomerates can be complex, with a large number of entities with in a group. More complex structures are likely to be less transparent and the close relationship between two, or more, businesses with substantially different characteristics and regulations creates room for risk management and supervisory challenges, regulatory arbitrage and conflicts of interests. Interconnectedness among group entities through ownership participations, intra-group transactions, and management processes all increase supervisory challenges. Clear and transparent group structures help in a resolution context by establishing clear ownership and intra-group relationships. FICOD1 introduced a requirement for financial conglomerates to submit to supervisors, and to publish information on their legal and organisational and management structure. This goes some way to ensure that supervisors have information on how a financial conglomerate is structured, in order to support supervision. However, FICOD is silent on what to do with the information that is submitted, so **effectiveness** may be hampered by the lack of details on the scrutiny of such structures. This was also highlighted in the Commission’s 2012 report, which mentions that FICOD lacks the requirement for the legal entity responsible for group compliance to be ready for any resolution, and to ensure clear group structure.

Efficiency

In response to the Commission Services’ public consultation no respondents highlighted issues related to the **efficiency** of the FICOD governance provisions. Respondents from the supervisory community highlighted the usefulness of requiring adequate governance requirements at the level of the financial conglomerate, but did not comment on whether analysis of these provisions incurred specific supervisory costs. Respondents from industry were silent on whether these requirements led to implementation costs for financial conglomerates.

Relevance

Since the initial adoption of FICOD, the sectorial landscape has evolved significantly. Both CRDIV and Solvency II have more developed requirements on governance than the previous sectorial regimes. Additionally since FICOD1, MFHCs are included in the scope of both sectorial regimes, which means that governance requirements applicable at the sectorial level are extended to the top level of a financial conglomerate.

Figure 2 and 3 show the evolution of the governance requirements in the sectorial and FICOD regimes. The original CRDI and various insurance directives are largely silent on the issue of governance provisions, including only basic requirements for internal control mechanisms. Therefore, the provisions that FICOD introduced – which specified the type of measures that should be included in risk management and internal control mechanisms – were significantly more detailed that the sectorial regimes. Additionally, the FICOD provisions placed the emphasis on having these provisions in place at the level of the financial conglomerate, introducing a group perspective that was largely absent at sectorial level.

The recitals of both CRDIV and Solvency II acknowledged that during the crisis it was apparent that poor corporate governance gave rise to risks. As such, both Directives recognise the need for robust governance provisions, and the ability for competent authorities to enforce these. As such, the governance regimes for both banks and insurers have been reinforced, as demonstrated in figure 4.

What is clear is that at the time of adoption of FICOD, there was added value in requiring specific governance requirements at the group level. However, due to changes and development of the sectorial regimes the **relevance** of the FICOD governance requirements has been diminished.

Coherence

Although the **relevance** of FICOD has been impacted by the development of more enhanced governance regimes at sectorial level, FICOD and the sectorial levels remain coherent. The governance provisions across the sectors and FICOD place the responsibility on entities and groups to design the precise nature of their governance arrangements. Due to this, groups can organise their governance provisions in a way which works for their structure, and satisfies the requirements in the various Directives. Due to the broad nature of the FICOD governance requirements, they have allowed developments at sectorial level without creating inconsistencies between the legislation.

Figure 2- Comparison of governance requirements at the time of FICOD adoption

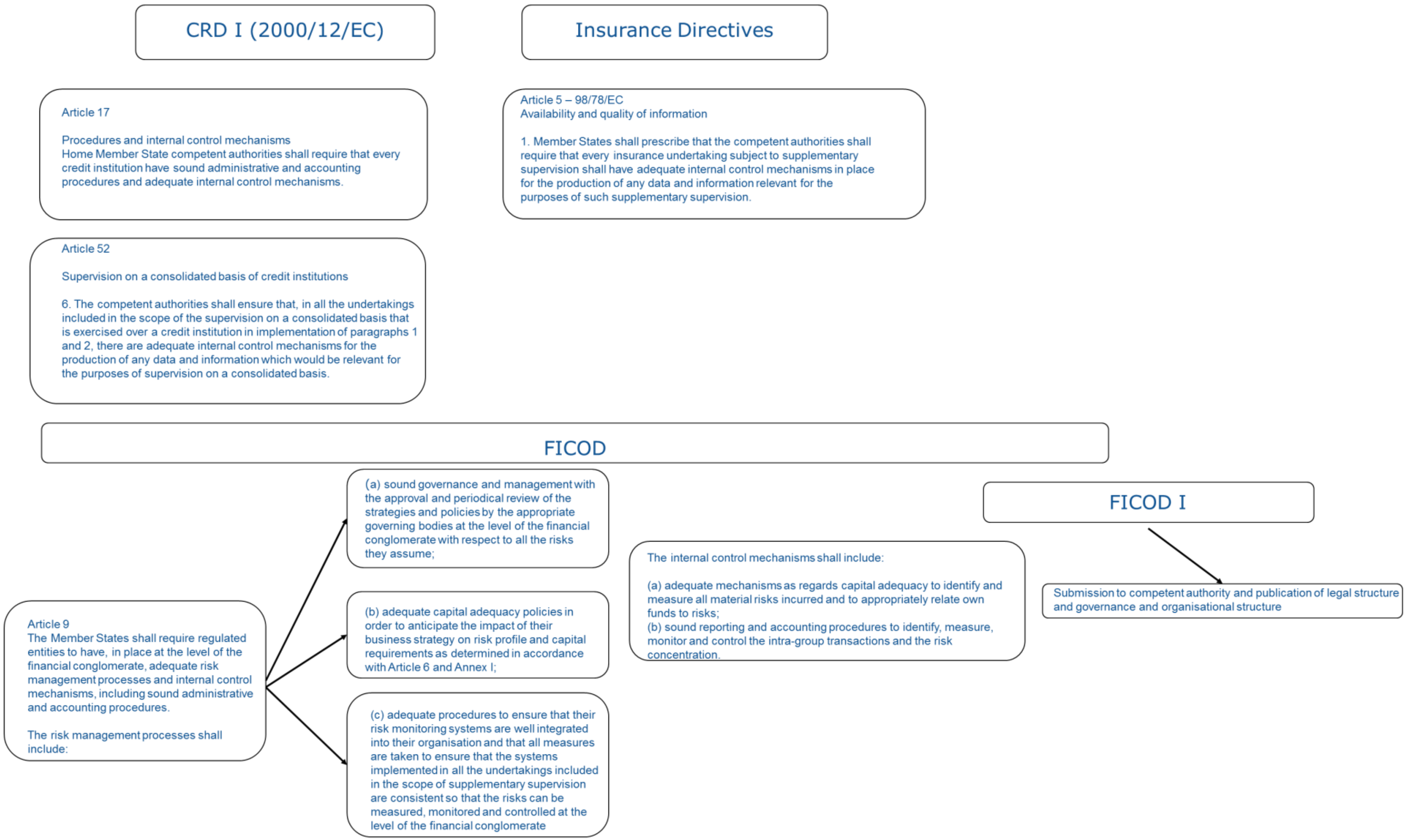


Figure 3 – CRDIV and Solvency II governance requirements

CRD IV (2000/12/EC)

Article 88

Governance arrangements

1. Member States shall ensure that the management body defines, oversees and is accountable for the implementation of the governance arrangements that ensure effective and prudent management of an institution, including the segregation of duties in the organisation and the prevention of conflicts of interest.

Procedures and internal control mechanisms
Home Member State competent authorities shall require that every credit institution have sound administrative and accounting procedures and adequate internal control mechanisms.

Those arrangements shall comply with the following principles:

(a) the management body must have the overall responsibility for the institution and approve and oversee the implementation of the institution's strategic objectives, risk strategy and internal governance;

(b) the management body must ensure the integrity of the accounting and financial reporting systems, including financial and operational controls and compliance with the law and relevant standards;

(c) the management body must oversee the process of disclosure and communications;

(d) the management body must be responsible for providing effective oversight of senior management;

(e) the chairman of the management body in its supervisory function of an institution must not exercise simultaneously the functions of a chief executive officer within the same institution, unless justified by the institution and authorised by competent authorities.

Member States shall ensure that the management body monitors and periodically assesses the effectiveness of the institution's governance arrangements and takes appropriate steps to address any deficiencies.

Solvency II

Article 41

General governance requirements

1. Member States shall require all insurance and reinsurance undertakings to have in place an effective system of governance which provides for sound and prudent management of the business.

That system shall at least include an adequate transparent organisational structure with a clear allocation and appropriate segregation of responsibilities and an effective system for ensuring the transmission of information. It shall include compliance with the requirements laid down in Articles 42 to 49.

The system of governance shall be subject to regular internal review.

Article 44

Risk management

Insurance and reinsurance undertakings shall have in place an effective risk-management system comprising strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report, on a continuous basis the risks, at an individual and at an aggregated level, to which they are or could be exposed, and their interdependencies.

That risk-management system shall be effective and well integrated into the organisational structure and in the decision-making processes of the insurance or reinsurance undertaking with proper consideration of the persons who effectively run the undertaking or have other key functions.

The risk management and internal control systems and reporting procedures shall be implemented consistently in all the undertakings included in the scope of group supervision pursuant to Article 213(2)(a) and (b) so that those systems and reporting procedures can be controlled at the level of the group.

Article 45

Own risk and solvency assessment

1. As part of its risk-management system every insurance undertaking and reinsurance undertaking shall conduct its own risk and solvency assessment.

That assessment shall include at least the following:

(a) the overall solvency needs taking into account the specific risk profile, approved risk tolerance limits and the business strategy of the undertaking;

(b) the compliance, on a continuous basis, with the capital requirements, as laid down in Chapter VI, Sections 4 and 5 and with the requirements regarding technical provisions, as laid down in Chapter VI, Section 2;

(c) the significance with which the risk profile of the undertaking concerned deviates from the assumptions underlying the Solvency Capital Requirement as laid down in Article 101(3), calculated with the standard formula in accordance with Chapter VI, Section 4, Subsection 2 or with its partial or full internal model in accordance with Chapter VI, Section 4, Subsection 3.

Article 245

Supervision of the system of governance

1. The requirements set out in Title I, Chapter IV, Section 2 shall apply mutatis mutandis at the level of the group.

Without prejudice to the first subparagraph, the risk management and internal control systems and reporting procedures shall be implemented consistently in all the undertakings included in the scope of group supervision pursuant to Article 213(2)(a) and (b) so that those systems and reporting procedures can be controlled at the level of the group.

Article 257
Member States shall require that all persons who effectively run the insurance holding company or the mixed financial holding company are fit and proper to perform their duties.

Also provisions on:

Internal control

Internal audit

Actuarial function

Outsourcing

4.2.4 Intra-group transactions and risk concentrations

4.2.4.1 State of play

One of the key tools supervisors have in the monitoring and control of group risks is the monitoring of intra-group transactions and risk concentrations. Intra-group transactions involve the monitoring of transactions between members of the same group to allow for greater understanding of the exposures between entities and to monitor (and eliminate at a group level) any possible intra-group creation of capital. Risk concentration means the possible excessive build-up of risk coming from a variety of sources, for example due to exposures to individual counterparties, groups of counterparties or specific products. In a financial conglomerate, when the exposures are aggregated across the group, these may be more significant than on a purely sectorial basis. The objective of the provisions in FICOD is to capture intra-group transactions and risk concentrations at the level of the financial conglomerate in order to better supervise these aspects at the group level. At the sectorial level, Solvency II already includes detailed provisions on intra-group transaction and risk concentration reporting. However, the rules for banking groups are structured differently – specifically intra-group transactions are dealt with through the large exposures regime which places limits on the exposure a credit institution can have to counterparty, or group of connected counterparties, including those parts of the same group). As shown in figure 4 below, the Solvency II rules are more similar (almost identical) to the FICOD provisions, whereas the CRR provisions are structured in a significantly different way.

Figure 4 - Intra-group transaction monitoring – compared

Solvency II

Definition of intra-group transaction:

'intra-group transaction' means any transaction by which an insurance or reinsurance undertaking relies either directly or indirectly on other undertakings within the same group or on any natural or legal person linked to the undertakings within that group by close links, for the fulfilment of an obligation, whether or not contractual, and whether or not for payment.

Reporting of intra-group transactions

The Member States shall require insurance and reinsurance undertakings or insurance holding companies to report on a regular basis and at least annually to the group supervisor all significant intra-group transactions by insurance and reinsurance undertakings within a group, including those performed with any natural person linked to any undertaking within the group by close links. In addition, Member States shall require reporting of very significant intra-group transactions as soon as is practicable.

Definition of significant intra-group transactions:

Participating insurance and reinsurance undertakings, insurance holding companies or mixed financial holding companies shall consider as significant intragroup transactions the intragroup transactions that materially influence the solvency or liquidity position of the group or of one of the undertakings involved in these transactions

Reporting of intra-group transactions:

The group supervisor, after consulting the other supervisory authorities concerned and the group, shall identify the type of intra-group transactions insurance and reinsurance undertakings in a particular group must report in all circumstances.

CRDIV/CRR

Definition of large exposure

An institution's exposure to a client or group of connected clients shall be considered a large exposure where its value is equal to or exceeds 10% of its eligible capital

Reporting of large exposures

Institutions must report:

- certain information on every large exposure
- additional information on in relation to its 10 largest exposures on a consolidated basis to institutions as well as its 10 largest exposures on a consolidated basis to unregulated financial sector entities

Reporting shall be carried out at least twice a year.

Limits on large exposures

An institution shall not incur an exposure to a client or group of connected clients the value of which exceeds 25 % of its eligible capital. Where that client is an institution or where a group of connected clients includes one or more institutions, that value shall not exceed 25 % of the institution's eligible capital or EUR 150 million, whichever the higher, provided that the sum of exposure values to all connected clients that are not institutions does not exceed 25 % of the institution's eligible capital.

FICOD

Definition of intra-group transaction:

'intra-group transactions' means all transactions by which regulated entities within a financial conglomerate rely directly or indirectly on other undertakings within the same group or on any natural or legal person linked to the undertakings within that group by close links, for the fulfilment of an obligation, whether or not contractual, and whether or not for payment

Reporting of intra-group transactions:

The Member States shall require regulated entities or mixed financial holding companies to report, on a regular basis and at least annually, to the coordinator all significant intra-group transactions of regulated entities within a financial conglomerate

Definition of intra-group transaction:

An intra-group transaction shall be presumed to be significant if its amount exceeds at least 5 % of the total amount of capital adequacy requirements at the level of a financial conglomerate.

Definition of a significant intra-group transaction:

An intra-group transaction shall be presumed to be significant if its amount exceeds at least 5 % of the total amount of capital adequacy requirements at the level of a financial conglomerate.

FICOD requires reporting on both significant intra-group transactions and significant risk concentrations but gives supervisory authorities the flexibility to define the format for this reporting. FICOD also allows supervisory authorities the option to set quantitative limits on intra-group transactions and risk concentrations – but does not require them to do so. The only requirement set out in FICOD is that any intra-group transaction which is greater than 5 percent of the total amount of capital adequacy requirements at the level of a financial conglomerate must be considered significant and therefore subject to the reporting requirements. Additionally, supervisors may apply the dominant sector's (banking or insurance) rules to the conglomerate as a whole.

The regulatory technical standards on intra-group transactions and risk concentrations adopted by the Commission in 2015 aim to bring greater harmonisation to this issue by setting out certain types of intra-group transactions and what risk exposures should be considered.[27] They also specify that transactions which are "part of a single economic operation" should be added together for the purpose of meeting the 5 percent threshold in Article 8.

4.2.4.2 Analysis

Effectiveness

Overall, respondents to our public consultation were clear that the intra-group transaction and risk concentration provisions in FICOD are a useful and **effective** supervisory tool, which add value over and above the sectorial requirements. Specifically, the intra-group transaction and risk concentration rules in FICOD specifically look at the financial conglomerate-wide position, which may be missing from a purely sectorial basis. The FICOD provisions support and strengthen the sectorial requirements as the detection and monitoring of build-up of excessive risks at group level has been one of the most important functions of FICOD.

Nevertheless, there are a number of issues with the way in which the intra-group transaction and risk concentration provisions work that may undermine the **effectiveness** of the provisions to address the specific prudential risks arising in financial conglomerates and to ensure a sound supervisory framework for the supervision of these groups.

The amount of supervisory discretion in FICOD may lead to level playing field issues. In particular, the ability for Member States to set quantitative limits leads to the situation where financial conglomerates in some Member States are subject to different treatments than others. For example, during consultation with supervisory authorities it was revealed that some supervisory authorities have set quantitative limits whereas others set the limits dependent on the size and nature of the group. This leads to level playing field issues where financial conglomerates are subject to different treatments depending on the decisions taken in different Member States. During the same consultation it was revealed that some Member

[27] Commission Delegated Regulation (EU) 2015/2303 of 28 July 2015 supplementing Directive 2002/87/EC of the European Parliament and of the Council with regard to regulatory technical standards specifying the definitions and coordinating the supplementary supervision of risk concentration and intra-group transactions (OJ L 326, 11.12.2015, p. 34).

States require specific reporting templates to be used for the reporting on intra-group transactions and risk concentrations; whereas others have no set template. This also creates an issue in relation to the SSM, where they are bound to implement Member States transposition of this provision. This means that the SSM are currently bound to apply a range of different rules on intra-group transactions and risk concentrations depending on the Member States' transposition of these provisions. Therefore, the development of the Banking Union has not addressed the level playing field issues in this area.

There is also a particular problem with quantitative limits where competent authorities choose to apply limits and calculation methods in the banking regulation to the conglomerate as a whole, and as such to the insurance entities in the group. In response to our public consultation, some supervisory respondents highlighted that this treatment was not appropriate for the insurance subsidiaries as Solvency II already considers concentration risk in the SCR and so the application of the banking rules may lead to a "double counting" of this kind of risk. It should be noted, however, that the supervisory discretion was appreciated by some respondents who commented that it was necessary to take account of specificities of different conglomerate business models.

Additionally, the definition of "significant" in FICOD refers to single intra-group transactions that exceed 5% of the total amount of capital adequacy requirements at the level of a financial conglomerate. In response to the Commission Services’ public consultation some respondents highlighted that there may also be cases where there are a number of smaller intra-group transactions that pass through single entities or "hubs" of entities which when added together are significant. Because FICOD does not explicitly consider this kind of significance, the supervisory **effectiveness** of the provisions may be undermined as it does not require supervisors to consider *all* kinds of significant intra-group transactions.

The **effectiveness** of the provisions may also be undermined by the interaction between the coordinator and the host authorities. In response to the Commission Services’ public consultation some respondents from supervisory authorities who are host supervisors for financial conglomerates highlighted that the identification and supervision of IGTs and risk concentrations under FICOD is the responsibility of the coordinator, and therefore there may be issues for host supervisors where they identify significant IGTs or risk concentrations which are not significant from the coordinator's perspective. However, the relevance of these intra-group transactions and risk concentrations from the overall group perspective may not warrant inclusion in reporting at financial conglomerate level.

Efficiency

Aside from the overlap with the Solvency II reporting requirements, it should also be considered whether the fact that there are many, and possibly overlapping, requirements in this area at sectorial and financial conglomerate level may be difficult to interpret and implement in practice, thus undermining the **efficiency** of the provisions and unduly increase costs of implementing these provisions – for both supervisory authorities and businesses.

Although FICOD requires the reporting of significant intra-group transactions and risk concentrations, it does not specify the format that this reporting should take. This may undermine the **efficiency** of FICOD as different competent authorities have taken different approaches to this reporting, as detailed above. Some Member States prescribe the format for the reporting to take, whereas others do not. The lack of harmonised reporting was highlighted by a number of supervisory respondents to our public consultation as an issue which undermines the comparability of this reporting across Member States.

Relevance

Due to the fact that the sectorial regime for insurers has developed to mostly replicate the FICOD requirements, the **relevance** of the FICOD provisions has diminished for insurance-led conglomerates. However, on the banking-side the focus of the large exposures regime does not have a specific group angle. This lack of specific group focus means that the FICOD requirements may have more relevance for banking-led conglomerates by bringing in this group aspect. This fact was highlighted by respondents to the Commission Services' public consultation and is supported by analysis by Commission Services.

Coherence

There are issues with the **coherence** of the FICOD requirements on intra-group transactions and risk concentration and the provisions under Solvency II. As mentioned above, Solvency II contains detailed provisions on intra-group transactions and risk concentrations and therefore for insurance-led conglomerates there may be a problem of duplicative reporting – having to prepare two different sets of reporting in different templates, which may not be harmonised, covering the same IGTs and risk concentrations for both FICOD and Solvency II purposes. For banking-led conglomerates, the banking provisions do no specifically deal with intra-group transactions, but these will be captured by the large exposures regime.

4.2.5 Supervision and enforcement

4.2.5.1 State of play

FICOD sets out a framework for supervisory cooperation among those supervisory authorities involved in the supervision of the entities within a financial conglomerate; this includes those involved in different sectors, as well as across borders (within the EU and with third countries).

FICOD sets out the criteria for identifying the "coordinator" which is the competent authority with the responsibility for exercising the supplementary supervision. Where a regulated entity is at the head of the financial conglomerate the coordinator will be the competent authority that has authorised that regulated entity. Where the head of the financial conglomerate is an unregulated entity (i.e., the mixed financial holding company) the coordinator will be the competent authority that has authorised the regulated entity that the mixed financial holding company is the parent of. FICOD also sets out a number of criteria for identifying the coordinator where the situation is less clear – for example where two regulated entities have as their parent the same mixed financial holding company.

FICOD contains a number of tasks for the coordinator with regard to the exercise of supplementary supervision. This includes assessing the financial conglomerate's compliance with the capital adequacy requirements; the requirements on risk concentration and intra-group transactions; and an assessment of the financial conglomerate's structure, organisation and internal control systems. It also includes the responsibility for the coordination and dissemination of relevant supervisory information.

One further concept in relation to supervisory cooperation is the distinction that FICOD draws between competent authorities and "relevant competent authorities." Relevant competent authorities are more involved in the supplementary supervision, alongside the coordinator, and must be involved in certain key decisions. FICOD defines relevant competent authorities as: (a) competent authorities responsible for the sectorial group-wide supervision (in particular of the ultimate parent); (b) the coordinator; and (c) any other competent authority who the authorities in (a) and (b) deem to be relevant.

As part of enhancing the supervisory cooperation under FICOD, the ESAs developed guidelines on the convergence of supervisory practices relating to the consistency of supervisory coordination arrangements for financial conglomerates[28]. These coordination arrangements set out how the various competent authorities involved in the supervision of financial conglomerates should cooperate and work together – including how information is exchanged and how decisions should be taken. The guidelines offer practical guidance on how competent authorities should work together.

[28] https://www.eba.europa.eu/documents/10180/936042/JC+GL+2014+01+%28Joint+Guidelines+on+coordination+arrangements+for+financi....pdf/dc406af7-3d2e-4cf6-907c-dd854e11b430

In addition to the supervisory framework set out in the FICOD, any requirements must be backed by appropriate enforcement action. FICOD contains the requirement for Member States to specify the measures that can be taken with respect to MFHCs. Currently, there is no EU-wide enforcement framework specific to financial conglomerates as a whole; instead enforcement is generally based on sectorial legislation. In this context "enforcement framework" refers to the ability of supervisors to impose sanctions and other supervisory actions in case of breach of the rules. FICOD requires that in cases where the provisions of FICOD are not met, or where they are met but there is a threat to the regulated entities' financial position, necessary measures should be taken by the coordinator and competent authorities to correct the position. However, FICOD leaves the nature of these measures at the discretion of Member States to specify.

4.2.5.2 Analysis

Effectiveness

One of the significant developments since FICOD's adoption has been the creation of the single supervisory mechanism (SSM) which now has responsibility for the supervision of a number of the banking-led financial conglomerates in the Banking Union. When FICOD was adopted the creation of such a supervisory body was not anticipated. As a result, FICOD refers to competent authorities being "the national authorities of the Member States" which may no longer be appropriate for the Single Supervisory Mechanism. This may undermine the **effectiveness** of FICOD in identifying the appropriate coordinator and therefore in ensuring a sound supervisory framework for financial conglomerates. Despite this discrepancy in language, the rules on the identification of the coordinator cover a sufficiently diverse range of scenarios and allow sufficient flexibility for the identification of the coordinator to be appropriately done. Another issue related to the identification of the coordinator is where the designated supervisory authority only has power to oversee one sector of the group – for example, a banking supervisor with powers only in relation to banking entities. Here there could be difficulties when the banking supervisor seeks information from the insurance arm of the financial conglomerate (or vice versa). The **effectiveness** of FICOD in ensuring a sound supervisory framework could be undermined by the lack of detail in this area.

Also related to the **effectiveness** of the supervisory provisions in FICOD is whether the tasks of the coordinator are sufficiently clear and understandable. In responding to our public consultation, some respondents argued that the additional layer of supervision required by FICOD leads to multiple levels of supervision which could be confusing. These multiple levels of supervision mean it can be unclear who would have ultimate decision making powers and there may be a risk of duplicating tasks. However, overall supervisory respondents felt that the supervisory cooperation required by FICOD was one of the key pieces of **added-value** that the Directive has, as it encourages interaction across Member States, but also across sectorial lines. This is particularly useful in cases where sectorial supervision is carried out by separate institutions. The promotion of sharing of information and supervisory cooperation was a welcome aspect of FICOD.

The current supervisory framework focusses on regulated entities, whereas there is a risk that financial conglomerates shift risks away from financial sectors to unregulated entities. There is also a risk that in groups that are active in both financial and non-financial sectors the financial entities are exposed to risks arising from the non-regulated activities which supervisors have insufficient oversight of. This undermines the **effectiveness** of FICOD, as it may mean FICOD does not capture all relevant prudential risks in these groups. This is linked to the lack of power over the ultimate responsible entity in the group, as discussed in sections 6.2.1.2 and 6.2.5.1. Supervisory authorities have limited powers over a holding company's balance sheet and cannot impose a capital requirement for the holding company. It is thus difficult to ensure that capital is held appropriately throughout a group, but also limits their ability to oversee possible contagion from non-financial entities to the financial entities of the group. Many supervisory respondents to our public consultation emphasised that supervision (including capital requirements) applied at the level of the head of a financial conglomerate remains essential to avoid regulatory arbitrage or misrepresentation of the financial position of the group. It is important that supervisory authorities have access to, and can hold accountable, the ultimate controllers of financial businesses to ensure that good quality capital, rather than excessive debt, is supporting the underlying financial businesses and in order to prevent regulated entities being put under pressure to support risks elsewhere in the group.

As stated above, currently there is no EU-wide enforcement framework for financial conglomerates. Instead, enforcement is based on sectorial legislation and national implementation. This may lead to level playing field issues between banking-led and insurance-led financial conglomerates, and across Member States which may undermine the **effectiveness** of the Directive. In particular, the article which sets out the enforcement measures in FICOD (Article 16) is drafted very broadly, which is in contrast to the provisions in, for example, CRDIV Article 4 and CRR Article 2.

Efficiency

The requirement for a specific supervisory framework for financial conglomerates is likely to have cost implications for supervisory authorities – for example, because supervisors will have to be trained to deal with cross-sector risks and to understand both the banking and insurance business of the financial conglomerate. However, in response to the Commission Services' public consultation no stakeholders specifically quantified the additional cost of supplementary supervision under FICOD and many respondents highlighted that the specific cross-sector focus of FICOD was a useful supervisory tool. In this case, any additional cost of cross-sectorial supervision was outweighed by the supervisory benefit of addressing the specific prudential risks in financial conglomerates.

There will also be a cost of compliance for firms subject to FICOD. However, in response to the Commission Services' public consultation, the industry did not raise any specific concern about the cost of complying with FICOD. Moreover, as detailed in section 5.2 , a study by Europe Economics on the cost of compliance with selected regulatory measures[29], including

[29] Europe Economics, (2009), Study on the Cost of Compliance with Selected FSAP Measures

FICOD, found the costs of complying with FICOD to be a limited amount of total operating costs.

Relevance

A key consideration of the **relevance** of FICOD supervision is to consider to what extent FICOD provides supervisory authorities or Member States with tools and powers to address the risks which may stem from the new structures in different financial sectors and different countries. As mentioned in previous sections, there has been a change in the market make up of mixed-activity financial groups. FICOD does not currently capture all these new structures[30], and so the overall supervisory **relevance** of FICOD may be undermined, as it does not allow supervisory authorities to address the risks stemming from these new structures which may undermine financial stability.

However, it should also be noted that FICOD provides a legal framework for further prudential supervision that complements the sectorial supervisory regimes in order to close loopholes in the sectorial legislation and address the specific group risks such as concentration risk and the risk associated with intragroup transactions and this for purpose it is still **relevant**.

Coherence

Additionally, when FICOD was adopted it aimed to provide supplementary supervision for complex large groups. It supplemented the then existing relevant sectorial frameworks: the Capital Requirements Directive (CRDIII) and the various insurance directives. However, the sectorial legislation in recent years has been significantly overhauled, with the adoption of CRR/CRD IV and the Solvency II Directive as well as in the securities sector. The enhanced supervisory framework at sectorial level may have diminished the supervisory **relevance** of FICOD, and may have also created issues with the **coherence** of the supervisory frameworks across the sectors and FICOD. Indeed, in response to the Commission Services' public consultation a number of respondents from supervisory authorities highlighted that there have been a number of developments at sectorial level which are not reflected in FICOD – for example, the more enhanced capital provisions which include Pillar 2 and capital add-ons. The fact that FICOD does not reflect these developments may lead to coherence issues between the interaction of the sectorial rules and FICOD.

This may undermine the **coherence** of the FICOD provisions. Additionally, it should be noted that there are no administrative sanctions for insurance undertakings in EU legislation, in contrast with the CRDIV. This may further exacerbate the level playing field issue between types of financial conglomerate (banking-led vs insurance-led).

[30] Please see section 3.3 for a description of these new structures

5 Conclusions

This Staff Working Document outlines the Commission Services' analysis of whether FICOD remains fit for purpose. It highlights a number of ways in which the effectiveness, efficiency, relevance, coherence and EU added value of FICOD has evolved and changed since its adoption in 2002.

A first conclusion of this report is that it remains important to keep in place a framework for the supervision of mixed-activity financial groups, a framework that is provided by FICOD. FICOD has, in general, functioned well and there is no evidence of failures of financial institutions which could have been perceived as due to the weaknesses in FICOD provisions.

The message received from the consultation – particularly from supervisory authorities – is that the consideration of group risks is still an important part of ensuring financial stability and investor protection. Many respondents to our public consultation also highlighted that the supervisory framework and cooperation laid down in the Directive was and remains a useful tool for promoting a closer relationship between supervisory authorities across Member States, and across sectors.

However, it should be noted that since the adoption of the original FICOD in 2002, the regulatory landscape in which Financial Conglomerates operate has changed significantly. The development of enhanced sectorial regimes, and in particular the enhanced group supervision regime under Solvency II, has changed the relevance and coherence of FICOD as, in many aspects, FICOD was not adjusted following those sectorial developments. Only the Delegated Regulations have been adjusted in this time, although with less detail than the sectorial provisions.

In addition to changes in the regulatory framework, there have also been a number of changes in the market which has led to the emergence of different types of mixed financial activity groups which FICOD did not envisage due its original focus on bancassurance groups. Further market monitoring will be necessary to accompany these new developments and identify any new issues of group supervision arising from them.

Since the adoption of the original FICOD in 2002, the regulatory landscape in which Financial Conglomerates operate has changed significantly. The development of enhanced sectorial regimes, and in particular the enhanced group supervision regime under Solvency II, has changed the relevance and application of FICOD, leading to a certain number of inconsistencies. However, the framework still functions to capture group risks and gives supervisors oversight over these cross-sector groups. In some instances the gaps and inconsistencies are addressed by supervisors in the application of the FICOD framework and therefore do not fundamentally undermine the effectiveness of the FICOD framework.

Overall, FICOD remains a useful supervisory tool.

Annex I – List of EU/EEA based FICOs at 2016 (assets and liabilities refer to 2015)

Institution Name	*Country Name*	*Total Assets (€B)*	*Total Liabilities (€B)*	*G-SIBs*	*G-SIIs*	*G-SIIs EBA*	*Waived*
HSBC Holdings	UK	2.219	2.037	*YES*		*YES*	YES
BNP Paribas	France	1.994	1.894	*YES*		*YES*	
Crédit Agricole Group	France	1.699	1.601	*YES*		*YES*	
Deutsche Bank	Germany	1.629	1.562	*YES*		*YES*	
Barclays	UK	1.520	1.430	*YES*		*YES*	YES
Banco Santander	Spain	1.340	1.242	*YES*		*YES*	YES
Société Générale	France	1.334	1.272	*YES*		*YES*	
Groupe BPCE	France	1.167	1.101	*YES*		*YES*	
Lloyds Banking Group	UK	1.095	1.031			*YES*	
ING Groep	Netherlands	1.005	957	*YES*		*YES*	
AXA	France	887	814		*YES*		YES
UniCredit	Italy	860	807	*YES*		*YES*	YES
Allianz Group	Germany	849	783		*YES*		
Goldman Sachs Int	UK	783	759	*YES*			YES
Banco Bilbao Vizcaya Argentaria (BBVA)	Spain	750	695			*YES*	YES
Crédit Mutuel Group	France	740	692			*YES*	
Intesa Sanpaolo	Italy	676	628			*YES*	
Coöperatieve Rabobank	Netherlands	670	629			*YES*	YES
Legal & General Group	UK	538	529				YES
Assicurazioni Generali	Italy	501	476				
Danske Bank	Denmark	441	420			*YES*	
Aegon	Netherlands	416	389		*YES*		
DZ Bank	Germany	408	389			*YES*	
ABN AMRO Group	Netherlands	406	388			*YES*	YES
Criteria Caixa	Spain	356	327			*YES*	
Svenska Handelsbanken	Sweden	275	261			*YES*	
Skandinaviska Enskilda Banken (SEB)	Sweden	272	257			*YES*	
DNB ASA	Norway	270	250			*YES*	
KBC Group	Belgium	252	237			*YES*	
La Banque Postale	France	219	210			*YES*	
Old Mutual	UK	181	169				
Belfius Banque	Belgium	177	168				
Monte dei Paschi di Siena	Italy	169	159				YES
HSBC France	France	168	163				
NN Group	Netherlands	162	141				
Governor and Company of the Bank of Ireland	Ireland	131	122				YES
OP Financial Group	Finland	125	116				

Achmea	Netherlands	93	83		
Unipol Gruppo Finanziario	Italy	90	81		
Wüstenrot & Württembergische	Germany	74	70		
Delta Lloyd	Netherlands	73	71		
Ibercaja Banco	Spain	59	56		
Novo Banco	Portugal	58	52		YES
KLP	Norway	57	49		
Debeka Lebensversicherungsverein	Germany	55	54		
Storebrand	Norway	54	51		
Banca Mediolanum	Italy	45	43		
Länsförsäkringar	Sweden	42	40		
Banco BPI	Portugal	41	38		YES
Argenta Bank- en Verzekeringsgroep	Belgium	39	37		
Sampo	Finland	38	24		
Uniqa Insurance Group	Austria	33	30		
Signal Iduna	Germany	31	30		
Schroders	UK	25	21		YES
LVM Konzern	Germany	20	18		YES
Skandia	Sweden	17	16		
Caixa Central de Crédito Agrícola Mútuo	Portugal	15	14		YES
Banque Neuflize	France	15	14		
Gjensidige Forsikring	Norway	13	11		
Bank of Valletta	Malta	10	9		YES
Aktia Pankki	Finland	10	9		
Avanza Bank Holding	Sweden	10	10		
INTER Krankenversicherung	Germany	9,0	8,7		YES
HSBC Bank Malta	Malta	7,2	6,8		
Nordnet	Sweden	6,6	6,4		
Bausparkasse Wüstenrot	Austria	6,1	5,6		
Alm. Brand	Denmark	4,7	4,0		YES
Grawe Group	Austria	4,6	8,4		
LocalTapiola General Mutual Insurance Company	Finland	3,7	2,6		
Sanlam Life and Pensions	UK	3,2	3,1		
Invesco Finance	UK	2,2	1,9		YES
Carlyle Trust	UK	2,0	1,7		YES
Eika Gruppen	Norway	1,2	1,0		
APG Asset Management	Netherlands	0,9	0,9		
Jernbanepersonalets Sparebank	Norway	0,7	0,7		

Eurohold Bulgaria	Bulgaria	0,5	0,4	
Taaleri	Finland	0,2	0,1	
Integrated Financial Arrangements	UK	0,1	0,0	YES
Baillie Gifford & Co.	UK	NA	NA	YES
Mutuelle Nat Hospit Prof Sante Social	France	NA	NA	
TOTAL		**27.755**	**26.086**	

Source: our elaborations on SNL and Capital IQ

Annex II – List of EU/EEA based FICOs at 2016 and their number of subsidiaries (2015)

Institution Name	*Country Name*	*Level 1*	*Level 2*	*Level 3*	*Level 4+*	*Total*
Uniqa Insurance Group	Austria	42	5	0	0	47
Bausparkasse Wüstenrot	Austria	3	1	0	0	4
Grawe Group	Austria	1	17	5	5	28
KBC Group	Belgium	2	27	16	7	52
Belfius Banque	Belgium	2	7	0	0	9
Argenta Bank- en Verzekeringsgroep	Belgium	1	1	0	0	2
Eurohold Bulgaria*	Bulgaria	18	8	3	0	29
Danske Bank	Denmark	10	2	2	0	14
Alm. Brand	Denmark	5	1	0	0	6
OP Financial Group	Finland	1	1	4	3	9
Sampo	Finland	5	28	16	11	60
Aktia Pankki	Finland	1	0	0	0	1
LocalTapiola General Mutual Insurance Company	Finland	2	0	0	0	2
Taaleri*	Finland	6	0	0	0	6
BNP Paribas	France	70	124	55	17	266
Crédit Agricole Group	France	4	6	28	223	261
Société Générale	France	69	99	26	9	203
Groupe BPCE	France	2	32	25	144	203
AXA	France	74	143	93	94	404
Crédit Mutuel Group	France	14	53	31	37	135
La Banque Postale	France	9	1	0	0	10
HSBC France	France	6	0	0	0	6
Banque Neuflize*	France	8	2	0	0	10
Mutuelle Nat Hospit Prof Sante Social*	France	4	2	0	0	6
Deutsche Bank	Germany	50	39	27	13	129
Allianz Group	Germany	9	192	76	221	498
DZ Bank	Germany	20	39	16	0	75
Wüstenrot & Württembergische	Germany	15	7	0	0	22
Debeka Lebensversicherungsverein*	Germany	4	0	0	0	4
Signal Iduna*	Germany	13	8	1	0	22
LVM Konzern	Germany	1	12	2	0	15
INTER Krankenversicherung	Germany	6	2	0	0	8
Governor and Company of the Bank of Ireland	Ireland	12	5	3	0	20
UniCredit	Italy	33	74	28	19	154
Intesa Sanpaolo	Italy	24	20	3	1	48
Assicurazioni Generali	Italy	43	92	44	8	187
Banca Monte dei Paschi di Siena	Italy	6	3	0	0	9

Unipol Gruppo Finanziario	Italy	7	16	3	2	28
Banca Mediolanum	Italy	3	4	0	0	7
Bank of Valletta	Malta	1	2	1	0	4
HSBC Bank Malta	Malta	0	0	0	0	0
ING Groep	Netherlands	6	18	16	2	42
Coöperatieve Rabobank	Netherlands	20	83	16	15	134
Aegon	Netherlands	19	27	15	55	116
ABN AMRO Group	Netherlands	1	13	1	0	15
NN Group	Netherlands	17	11	12	7	47
Achmea	Netherlands	52	5	0	0	57
Delta Lloyd	Netherlands	12	3	3	0	18
APG Asset Management*	Netherlands	4	1	0	0	5
DNB ASA	Norway	2	10	5	3	20
KLP*	Norway	13	15	2	1	31
Storebrand	Norway	7	8	4	1	20
Gjensidige Forsikring	Norway	16	1	0	0	17
Eika Gruppen	Norway	6	0	0	0	6
Jernbanepersonalets Sparebank	Norway	0	0	0	0	0
Novo Banco	Portugal	10	4	0	0	14
Banco BPI	Portugal	7	1	0	0	8
Caixa Central de Crédito Agrícola Mútuo	Portugal	1	2	2	0	5
Banco Santander	Spain	54	71	51	24	200
Banco Bilbao Vizcaya Argentaria (BBVA)	Spain	38	45	28	2	113
Criteria Caixa*	Spain	5	0	0	0	5
Ibercaja Banco	Spain	1	0	0	0	1
Svenska Handelsbanken	Sweden	6	4	0	0	10
Skandinaviska Enskilda Banken (SEB)	Sweden	14	8	2	1	25
Länsförsäkringar	Sweden	4	4	1	0	9
Skandia*	Sweden	7	20	9	1	37
Avanza Bank Holding	Sweden	3	0	0	0	3
Nordnet	Sweden	2	2	2	3	9
HSBC Holdings	United Kingdom	9	24	46	126	205
Barclays	United Kingdom	4	50	34	20	108
Lloyds Banking Group	United Kingdom	2	12	40	13	67
Goldman Sachs International	United Kingdom	0	0	0	0	0
Legal & General Group	United Kingdom	23	7	10	9	49
Old Mutual	United Kingdom	91	19	31	128	269
Schroders	United	7	6	6	16	35

	Kingdom					
Sanlam Life and Pensions UK	United Kingdom	NA	NA	NA	NA	NA
Invesco Finance	United Kingdom	NA	NA	NA	NA	NA
Carlyle Trust	United Kingdom	NA	NA	NA	NA	NA
Integrated Financial Arrangements*	United Kingdom	3	2	0	0	5
Baillie Gifford & Co.*	United Kingdom	3	3	0	0	6

Source: own calculations based on available data on subsidiaries from SNL Financial and Capital IQ when marked with an asterisk

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Annex IV: Procedural information concerning the process to prepare the analysis

The lead DG for this analysis was DG FISMA.

Work began on the evaluation in January 2016. The chronology of the process was as follows:

- Q1 2016: Preparation of the public consultation document
- Q2: Publication of public consultation (June 2016). On-going economic analysis.
- Q3: On-going economic analysis and analysis of existing data sources. Closure of the public consultation (September 2016).
- Q4: analyses of consultation replies; cross-referencing with existing data sources; drafting of the Staff Working Document and consultation with the ISSG.

As part of the process an Inter-service Steering group (ISSG) was set up to guide the analysis process. The following DGs were involved in the ISSG; DG GROW; DG JUST; DG ECFIN; Secretariat General; and Legal Services. The group met three times. The first meeting introduced the topic of FICOD and the purpose of the process. The group then met before the publication of the public consultation to agree the consultation document. The ISSG then met following the closure of the public consultation to discuss the draft of the Staff Working Document. Following comments from the ISSG, the Staff Working Document was revised and circulated to the group for final comments. This draft reflects the comments received from the ISSG during this process.

This Staff Working Document draws on information received during the public consultation held in 2016. It also uses information from previous consultations undertaken by Commission Services including informal consultation with supervisory authorities in 2015 and the Joint ESAs' response to the Commission Call for Advice in 2012. Further details of these consultations can be found in Annex V. The Staff Working Document also draws on the Commission's 2012 Report on the evaluation of FICOD and the Staff Working Document that accompanied it.

Further analysis draws on academic literature on the subject (a full list of references is attached with this Staff Working Document). The economic analysis included in the report draws on data sources provided by Bureau van Dijk (Orbis) and Standard & Poor's (Capital IQ, SNL Financial). The raw data was cross-checked to avoid double-counting of subsidiaries and subsequently analysed taking into account the respective issue to be presented in the graphs and tables. Furthermore, in cases where the types of subsidiaries were relevant, a mapping of the types of subsidiaries given in the databases on the broader classes Banks, Insurance, Asset Management, and Others was implemented. Limitations on data availability led to the use of several data providers in order to cover a more comprehensive set of FICOs. Data on individual firms was sourced from one data provider in order to avoid inconsistency issues.

Annex V – Synopsis Report

1. Introduction

This report summarises (1) the consultation strategy of the Commission services in the context of the evaluation of FICOD; and, (2) the outcome of the various public consultations and parallel consultations that have touched upon aspects related to FICOD. These include:

- A public consultation held during the course of 2016 specifically dedicated to FICOD;
- Reponses related to FICOD in the context of the Call for Evidence, i.e. the more general stock-take of post-crisis regulation; and
- Targeted consultations with Member States and supervisory authorities regarding FICOD's provisions related to capital adequacy requirements.
- Informal consultation with the Joint Committee's sub-committee on financial conglomerates (JCFC).

2. Consultation strategy

Stakeholder consultation was very important in contributing to the analysis of FICOD. As stakeholders are the ones who apply and are subject to the rules, understanding their perspective and experience in applying the Directive were key in understanding how effectively FICOD is meeting its objectives.

To ensure that relevant input of the highest possible quality and broadest range of views are received, the relevant stakeholder groups were identified and consulted in a manner most appropriate for them. This included a 12-week public consultation in English via an online questionnaire, as well as additional further targeted roundtables and discussions with supervisors through the ESAs joint committee’s sub-committee on financial conglomerates (JCFC).

Due to the technical nature of the FICOD capital adequacy requirements, this is an area where further targeted consultation took place, in order to ensure appropriate input in this area.

For the purpose of the consultation, at least the following stakeholders were identified:

Financial conglomerates: financial conglomerates are the most obvious group of stakeholders as they are directly impacted by the application of the rules in FICOD. They are also aware of how they manage risk, and how the interactions between FICOD and sectorial legislation affect them in terms of regulatory burden and overlap.

Financial institutions in general: these entities may compete with financial conglomerates, they may have been subject to FICOD and subsequently waived from the scope due to supervisory discretion (or not identified as a financial conglomerate due to supervisory discretion) or may become subject to FICOD in the future.

National supervisors of financial conglomerates: alongside financial conglomerates, the supervisors of these groups can be considered the most obvious group of stakeholders. These stakeholders use the rules within FICOD on a daily basis and are well placed to observe how well FICOD achieves its objectives by equipping them to address the risks posed by financial conglomerates.

The Single Supervisory Mechanism ("SSM"): A key supervisor of financial conglomerates is the SSM, who has responsibility for the supervision of a number of banking led conglomerates. Its experience in applying FICOD will be key for evaluating FICOD.

The European Supervisory Authorities ("ESAs"): The ESAs have a sub-committee on financial conglomerates that are contributing to policy and legislative work in the area of supervision of financial conglomerates and in policy areas that are relevant for financial conglomerates. Their input will be key for evaluating FICOD.

National ministries: these stakeholders are responsible for the transposition of the rules in FICOD and may be involved in their implementation. They are likely to have views on the rules in FICOD, in particular how they interact with relevant other EU legislation.

Non-governmental organisations, think tanks and others: these stakeholders include consumers of the services provided by financial conglomerates and their representatives (*e.g.*, Finance Watch and FSUG) that may have views on the importance of these institutions to real economy, think tanks and academics. Their input is also relevant for the evaluation of whether FICOD has safeguarded creditors' and policyholders' interests, as mentioned above.

In order to ensure that these stakeholders had the opportunity to respond to the public consultation, Commission Services reached out to publicise the consultation in a number of ways. This included contact with the Joint Committee's sub-committee on financial conglomerates (JCFC) to ensure supervisory authorities were aware of the opening of the public consultation. Commission Services also emailed the regulatory affairs contacts at the financial conglomerates identified under FICOD in order to offer them the opportunity to respond. In order to reach out to financial services users Commission Services also presented at the Financial Services User Group to inform them of the consultation.

The above approach follows the consultation strategy that was published at the beginning of the exercise and was generally successful in targeting the range of stakeholders identified.

3. Public Consultation on the Directive 2002/87/EC – June-September 2016

3.1. Introduction

The public consultation on the financial conglomerate directive ("FICOD") was designed to gather evidence on the Directive on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate ("FICOD") and its implementation to date (including regulatory technical standards).

The purpose of the consultation was to gather evidence in order to help Commission Services in the evaluation of whether the current FICOD regulatory framework is proportionate and fit for purpose, and delivering as expected considering its objective of identifying and managing risks that are inherent to financial conglomerates to ensure financial stability.

The public consultation was split into sections which focused on the key measures of the Directive: the identification of captured entities; risk management in financial conglomerates; and supervision and enforcement. Questions were grouped around these three main "building blocks" and focused on asking the experience of applying the measures in FICOD. The consultation also asked respondents to give evidence to support their answers, and also asked for the respondents to quantify impacts where possible.

3.2. Overview of Respondents

The Consultation ran from 09 June 2016 to 20 September 2016. By the set deadline 34 online responses were received from stakeholders with differing backgrounds. While there are 16 responses from the public sector, the 18 responses from the private sector are presented in Figure 1 below. A breakdown of responses by Member State can be found in Table 1.

Figure1: Number of responses and types of stakeholders from private sector

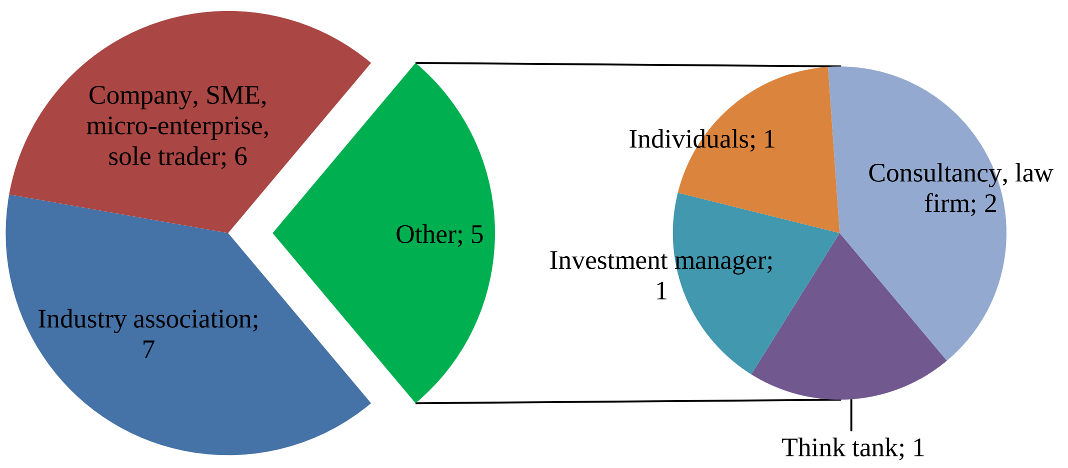

Table 1: Breakdown of responses by Member State:

Cross-Europe	1
Austria	3
Belgium	3
Croatia	1
Denmark	2
Finland	1
France	3
Germany	6
Italy	2
Poland	2

Spain	1
Sweden	2
The Netherlands	3
United Kingdom	4

3.3. Summary of the replies

The replies to the consultation are integrated in the SWD (Section 6) and summarised in the feedback statement accompanying this SWD.

4. Additional consultation on capital adequacy calculations – September 2016

4.1. Introduction

The Commission Services also undertook a specific consultation on the FICOD capital adequacy calculation in order to gather feedback on this complex part of FICOD. This consultation took place following the general public consultation that ran from June 2016 – September 2016. This consultation was targeted in order to engage with experts in the field of applying the capital calculation. To this end, Commission Services targeted the JCFC and the Commission Expert Group on Banking, Payments and Insurance (CEGBPI).

4.2. Overview of respondents

A discussion note which was shared with the JCFC and (CEGBPI) and following the circulation of the note, specific discussions were held by teleconference with JCFC and through a physical meeting of the CEGBPI. This allowed the opportunity for supervisory authorities and national ministries to comment on this important aspect of FICOD. Commission Services also had a number of ad hoc meetings with stakeholders from supervisory authorities and industries to discuss their concerns.

4.3. Summary of the replies

Overall the respondents felt that the clarity of the capital calculations in FICOD could be improved. In particular, a number of respondents highlighted that the RTS on the application of capital calculation could be improved to support a more harmonised application of the capital calculations. However, respondents did not present evidence of significant problems in applying the capital calculations.

5. Public consultation - Call for Evidence: EU regulatory framework for financial services.- January 2016

5.1. Introduction

On 30 September 2015, the European Commission launched a public consultation entitled the Call for Evidence: EU regulatory framework for financial services. The consultation closed on 31 January 2016.

The purpose of the Call for Evidence, which is part of the Commission's 2016 work programme as a REFIT item, was to consult all interested stakeholders on the benefits, unintended effects, consistency, gaps in and coherence of the EU regulatory framework for financial services. It also aimed to gauge the impact of the regulatory framework on the ability of the economy to finance itself and grow.

5.2. Overview of Respondents

Overall, the Commission received 288 responses to the Call for Advice. These were subsequently split up into individual claims in order to respond to stakeholders' specific concerns. Of these individual claims, around 20 claims related to FICOD. The responses related to FICOD came from a mix of supervisory authorities, industry bodies and

5.3. Summary of the replies

Most claims received in relation to FICOD concerned links between individual rules and overall cumulative impact as well as overlaps, duplications and inconsistencies. Generally claims relate to the fact that changes in the sectorial legislation have changed the relevance of FICOD, or has increased the complexity of applying the rules as the interactions between FICOD and the sectorial legislation is not always clear. Some claimants argued that FICOD should be reviewed in light of changes to sectorial legislation. Specifically some claims called for reconsidering the merits of supplementary supervision when sectorial requirements already cover all risk, in particular because Solvency II's enhanced group regime reduces the relevance for insurance-led conglomerates.

6. REFIT Platform Opinion on the submission by the German Insurance Association on the Financial Conglomerates Directive

6.1. Introduction

In June 2016 the REFIT Platform adopted an opinion on the submission from the German Insurance Association concerning FICOD.

6.2. Overview

The REFIT Platform recommended that the Commission undertake a review of FICOD to assess how it interacts with the sectorial legislation.

7. Informal consultation with JCFC – June 2015

7.1. Introduction

In June 2015 Commission Services undertook informal consultation with the JCFC in order to gather evidence on the supervisory experience of applying FICOD.

7.2. Overview of Respondents

Commission Services received responses from 15 Member States. 5 of the responses were from smaller Member States who stated that they were unable to answer the questions due to limited or no experience supervising financial conglomerates. The remaining responses cover most of the Member States where financial conglomerates are headed.

7.3. Summary of the Replies

JCFC highlighted that the areas in the Commission's 2012 Report on a review of FICOD remain relevant. However there were fewer comments addressing whether there are issues beyond the 2012 Report that should be considered as needing further review. One area that was raised that was not covered in the 2012 Report was the need for clarity and refinement of the legal text in FICOD – including in relation to the creation of the SSM which now has supervisory responsibility for a number of financial conglomerates.

Other areas raised by members were:

- The identification of the ultimate parent entity and the strengthening of the enforcement towards that entity were highlighted as important issues.
- The possible inclusion of unregulated entities (also non-financial entities) in the scope of FICOD was highlighted by a number of members - in particular the need to have access to information from these entities in order to understand the risk profile of the group and the risks that may be posed to the regulated financial entities by these other entities.
- Many members said that they had not experienced specific problems with the thresholds in Article 3, however some mentioned that there could be improvements to the clarity in the application of the thresholds. There is a need for clarity whether these thresholds capture the correct groups for the purposes of supplementary supervision.
- The waivers available were generally used to relieve administrative and supervisory burden on groups, particularly where the cross-sectorial nature of their business was not deemed to be significant.
- There were also a number of comments relating to the calculation of the conglomerate capital requirement. Although the RTS (Art 6.2, FICOD) have provided some clarity, there may still remain issues arising from inconsistencies between the sectorial capital regimes.
- Members generally acknowledged that FICOD provided tools for additional oversight of cross-sectorial groups. However, the additional benefit provided to those conglomerates which are insurance-led may be more limited due to the enhanced group supervision regime under Solvency II. Members also mentioned the need to examine how this enhanced regime interacts with the supplementary supervision regime under FICOD.