Opinion of the European Central Bank (13 September 2001)

Caption: Example of opinion delivered by the European Central Bank (ECB). Under the first indent of Article 105(4) of the EC Treaty, the ECB shall be consulted on any proposed Community act in its fields of competence. Accordingly, Article 105(5) of the EC Treaty stipulates that 'the ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system'.

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Opinion of the European Central Bank of 13 September 2001

at the request of the Council of the European Union on a proposal for a Directive of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2001/12/EC of the European Parliament and of the Council (COM(2001) 213 final)

(CON/2001/25)

(2001/C 271/06)

1. On 21 May 2001 the European Central Bank (ECB) received a request from the Council of the European Union for an opinion on a proposal for a directive of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2001/12/EC of the European Parliament and of the Council (COM(2001) 213 final) (hereinafter referred to as 'the proposal'). Its aim is the establishment of common prudential standards for the supervision of financial conglomerates throughout Europe. More specifically, the proposal provides that where credit institutions, insurance undertakings and investment firms, having their head office in the EU, are part of a financial conglomerate, they are submitted to supplementary prudential supervision. In order to ensure a proper framework, the proposal envisages a role for a coordinating authority (the coordinator) to be appointed amongst the competent authorities concerned. In addition, the proposal introduces some amendments to sectoral prudential regulation in order to avoid unlevelled playing fields amongst regulated entities of different financial sectors.

2. The ECB's competence to deliver an opinion is based on the first indent of Article 105(4), of the Treaty establishing the European Community (hereinafter referred to as 'the Treaty'), and Article 3.3 of the Statute of the European System of Central Banks and of the European Central Bank, as the proposal contains provisions concerning the prudential supervision of credit institutions and has the objective to foster the stability of the financial system. In accordance with the first sentence of Article 17.5, of the Rules of Procedure of the European Central Bank, the Governing Council of the ECB has adopted this opinion.

3. The aim of the proposal is the introduction of specific prudential legislation for financial conglomerates, therefore addressing a major lacuna in the EU prudential framework, as certain groups of financial institutions are not covered as such by existing sectoral regulation. The proposal introduces supplementary supervision to be applied to regulated entities that are in a financial conglomerate, focusing on capital adequacy, intra-group transactions and risk concentration. In addition, since financial conglomerates include regulated entities usually subject to different sectoral supervisory authorities within each Member State, or possibly undertakings based in different Member States, a high degree of coordination between all the authorities involved is necessary. The proposal meets the need for enhanced coordination between all authorities involved by introducing measures to facilitate supplementary supervision, namely regarding the appointment and the tasks of a coordinating authority and the exchange of information between competent authorities. Chapter IV of the proposal introduces some amendments to sectoral Community legislation in order to ensure a level playing field between financial conglomerates and 'homogenous' financial groups, engaged in one financial sector only.

4. The ECB broadly welcomes and supports the proposal. The ECB sees the proposal in the light of the need to provide increasingly integrated European financial markets with an adequate framework at Community level for the pursuance of financial stability. From the ECB's perspective, changes in financial markets prompted by the introduction of the euro call for a substantial enhancement of the mechanisms for cooperation between national authorities and also with the Eurosystem. The proposal draws an initial framework for the prudential regulation and supervision of financial conglomerates, which may be regarded

as being coherent overall. The ECB welcomes the proposal's objectives, notably of addressing the issue of capital adequacy in financial conglomerates, in particular the avoidance of multiple gearing, of establishing monitoring of intra-group transactions and of ensuring adequate cooperation among the competent authorities. The ECB shares the interest that a solid institutional and regulatory framework for the prudential supervision of financial conglomerates will be achieved in the Community. This is with due consideration to general requirements regarding the transparency and the clarity of arrangements, legal certainty, and the appropriate distribution of tasks and competences among the relevant authorities. The recognition of the financial stability role of central banks and of the contribution they may provide to the conduct of prudential supervision should also be an element of such framework. In general, the ECB would see scope for the proposal to go further in clarifying certain issues in the prudential supervision of a financial conglomerate than presently envisaged (see further below).

5. First, the definition and the identification of a financial conglomerate. As a preliminary remark, the ECB considers that a thorough mapping of the existing conglomerates in Member States is essential to understand the concrete impact and scope of the proposal. With regard to the concrete identification of a financial conglomerate, as determined under Article 2(13) and Article 3, the ECB considers that the proposal could define a procedure for identifying a financial conglomerate. The initiative for reporting the existence of a financial conglomerate could, in principle, be the responsibility of the entities comprising such conglomerate. The competent authorities, on the other hand, could be responsible for scrutinising whether regulated entitities comprise a conglomerate and for confirming the reporting provided by the entities comprising the conglomerate. In any case, the competent authorities would have the final responsibility for reaching a common agreement on the identification of a financial conglomerate. In this context, it could be an additional task of the coordinator to notify the Commission of conglomerates, for instance in similar terms to those in place for authorised credit institutions (Article 11 of Directive 2000/12/EC) ([1]). In addition, a list of the financial conglomerates subject to supplementary supervision, together with the regulated entities that comprise each conglomerate, and of their respective coordinators could be published, for instance on a yearly basis, in the *Official Journal of the European Communities.*

6. The scope of application hinges upon a definition of financial conglomerate, which comprises the following elements: the presence in the group of both one insurance or reinsurance undertaking and at least one other entity of a different financial sector; the presence in the group of at least one regulated entity (credit institution or investment firm or insurance undertaking); significant cross-sectoral activities; and the provision of mainly financial services. With regard to this last criterion, the ECB would like to highlight three aspects. First, the provision of mainly financial services, is dependent on a definition of 'financial sector'. The latter definition, set out in Article 2(7), comprises the banking, insurance and investment services sectors. The ECB notes that this definition does exclude from the financial sector a major part of the collective asset management business. This does not seem adequate, given the nature and importance of that business segment in the financial services industry. In this context, the ECB recalls that, following the definitive adoption of the proposal for a directive amending the Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) with a view to regulating management companies and simplified prospectuses ([2]), management companies will be subject to harmonised prudential rules. The amendments to the abovementioned Directive will allow management companies to perform also management of portfolios of investments in financial instruments on a client-by-client basis, a service also provided by banks and investment firms. The provision of collective asset management services should therefore be included in the definition of the 'financial sector'. In addition, it is noted that Article 4 of the proposal provides that supplementary supervision is applied to all regulated entities within the financial conglomerate, which are either at the head of the conglomerate or subsidiaries of a mixed financial holding company with the head office in the Community, or linked by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC ([3]), or otherwise within the scope of the proposal according to its Article 4. Article 2(4) of the proposal defines 'regulated entity' as credit institutions, insurance undertakings and investment firms. In light of the above, the ECB suggests including, on the basis of a cost benefit analysis, management companies in the definition of a regulated entity laid down in Article 2(4) and thus subject them to supplementary supervision according to the proposal.

Secondly, the ECB would suggest that the threshold specified in Article 3(1) could include off-balance sheet items for the purposes of the calculation of the relevance of the banking and investment sectors within a group. The inclusion of off-balance sheet items is made conditional upon the common agreement of competent authorities under Article 3(3)(c) of the proposal. However, reporting based solely on on-balance sheet items may be deemed insufficient in cases where off-balance sheet items form a significant share of the complete range of activities.

Thirdly, also regarding Article 3(1), the ECB notes that the proposal does not address the possibility of partially-owned entities, where the calculation of thresholds using total balance sheet figures may be somewhat misleading. Therefore, Article 3(1) could also allow for threshold calculations using figures on a pro-rata basis.

7. In order to enable identification of entities within a financial conglomerate, Article 2(11) of the proposal defines 'group' with a reference to the existence, between natural or legal persons, of 'close links'. The latter notion draws on the concept of close links as introduced in the sectoral directives by the so-called post BCCI Directive (Directive 95/26/EC) ([4]), which mainly refers to undertakings that, according to Directive 83/349/EEC, have to prepare consolidated accounts. In addition, the definition used by Article 2(12) of the proposal covers other situations, such as, for instance, 'a situation in which in the opinion of the competent authorities one or more persons effectively exercise a dominant influence over another person', regardless of the fact that such dominant influence is exercised pursuant to a contract or to a provision in the undertaking's articles of association (as it is instead required for the consolidation of accounts by the relevant directive). While it is well understood that the competent authority should have enough flexibility in defining which entities are to be included in financial conglomerates and should be subject to supplementary supervision, it is submitted that the necessary uniformity in the future application of the proposal throughout the Member States should not be impaired.

8. Secondly, the exercise of supplementary supervision and the role of the coordinator. The ECB notes that there is no formal definition of the recurrent term of 'competent authorities responsible for exercising supplementary supervision', for instance as referred to in Article 5(1), Article 6(1) and Article 7. The heading of Article 7 and the wording of Article 7(1) imply that the competent authority responsible for supplementary supervisions is in fact the coordinator. This point should be clarified. The ECB considers that it may not be a workable solution for the coordinator, under Article 7(1), to be composed of more that one competent authority. This means that the coordinator may comprise several competent authorities. The ECB understands that the role of a coordinator should contribute towards reducing complexity rather than increasing it. Therefore, the ECB would prefer that the role of coordinator be assigned to one competent authority only. The ECB also notes that, under Article 7(3) of the proposal, the coordinator for the supplementary supervision with regard to the financial conglomerate shall inform the competent authorities of the other Member States involved and the Commission of its identification. The ECB considers that the requirements for transparency of the Community's institutional framework for financial supervision imply that the identification of the coordinator should also, by force of law, be communicated to the regulated and unregulated entities comprising the financial conglomerate, for instance through the parent company of the conglomerate or the regulated institution located in the jurisdiction of the coordinator, and also to the general public. For instance, in this sense, the International Monetary Fund's 'Code of good practices on transparency in monetary and financial policies', in Section 5.1.2, points out that 'the responsibilities of the financial agencies and the authority to conduct financial policies should be publicly disclosed'. In this connection, the ECB should like to note that most provisions of the proposal rely on cooperation and coordination arrangements between competent authorities. For instance, this is the case of Article 3(3), Article 4(4), Article 5(5), Article 6(6), Article 13(2), and Annexes I and II. The workability of all these provisions depends, therefore, on the establishment of concrete and written arrangements and agreements among the competent authorities of the regulated entities comprising the conglomerate. The ECB considers that competent authorities should have the possibility to make such agreements public, preferably by publishing them in the Official Journal of the European Communities. In addition, with regard to the implementation of these arrangements, the ECB considers that some degree of convergence should be achieved regarding their main elements, while safeguarding the necessary flexibility of supervisory arrangements, in order to achieve adequate transparency and clarity of the supervisory framework, as well as

equal and effective supervisory treatment across financial conglomerates.

9. With regard to the provisions concerning the appointment of the coordinator, under Article 7(2), the ECB would prefer that the objective criteria listed in this provision prevail over the discretion of competent authorities to reach an ad-hoc agreement on the coordinator, while the latter may remain as an alternative solution. This is justified on the basis that objective criteria for the appointment of the coordinator better serve the requirements of transparency, clarity and legal certainty regarding the supplementary supervision of financial conglomerates. The ECB notes, in addition, that certain principles for identifying a coordinator, namely under Article 7(2)(b) (ii), (iii) and (iv), depend on factors that may be changing over time, such as the 'largest balance-sheet total'. In this context, the ECB considers that the appointment of the coordinator should, in all cases, be fixed for a specified minimum period of time, which could be defined in the proposal, independently of variations on such dynamic factors, unless major changes in the composition of the conglomerate occur. This would not only ensure a certain degree of continuity in supplementary supervision but would also be justified by the requirements for transparency, clarity and legal certainty.

10. With regard to the tasks of the coordinator under Article 8, the ECB welcomes the proposed list of mandatory assignments. The ECB considers that the coordinator should be entrusted with an active role regarding the monitoring of the financial conglomerate. The ECB would propose, for the sake of transparency and clarity vis-à-vis market participants and the public in general, that in addition to the set of tasks under Article 8(1), the coordinator be assigned the task of coordinating, in agreement with the competent authorities and in observance of sectoral rules, the communication to the general public of decisions which are relevant for the financial conglomerate as a whole.

11. The ECB notes that also the exercise of supplementary supervision with regard to capital adequacy, intra-group transactions and risk concentration is dependent on effective cooperation arrangements between the competent authorities. This may lead to some uncertainty about the structure of the prudential framework, which, as a matter of principle, should be well defined throughout and not weakened by ambiguities about its effectiveness. The issue of level playing field among financial institutions may become increasingly relevant within the proposed framework and the risk of regulatory arbitrage should be avoided as much as possible. For instance, cross-sector capital at the level of the financial conglomerate should be defined to avoid possible ambiguities, since the sectoral directives are not harmonised as regards own funds elements. Furthermore, the proposal does not clarify which national legislation will apply to the supplementary supervision of the conglomerate. According to Article 8(1)(b), the law of the Member State where the coordinator is based would seem to apply. However, this interpretation may be questioned by the reading of Annexes I and II, which generally provide that competent authorities should reach an agreement on the application of prudential rules. The ECB considers that a solution for achieving greater clarity would be to stipulate that the relevant national legislation of the Member State where the coordinator is based is the law applicable to the activities carried out by the coordinator in the supplementary supervision of the financial conglomerate. However, the proposal would have to clarify the applicable legislation in those cases where the coordinator is composed of more than one competent authority. On the other hand, certain provisions of the proposal provide scope for the competent authorities to participate in the exercise of supplementary supervision. For instance, the enforcement of measures aimed at ending observed breaches, under Article 13, is in the power of the competent authorities. In this sense, the application of measures by a supervisory authority to entities of a financial conglomerate located in another Member State may give rise to problems of conflict of laws and of identification of the competent court for review. Therefore, the ECB suggests that the proposal differentiates more precisely between the execution of supervisory tasks, to be undertaken by competent authorities, and the role of the coordinator.

12. Thirdly, crisis management. The ECB understands that the prudential supervisory framework set out in the proposal encompasses crisis management situations at the financial conglomerate level. In particular, the tasks of the coordinator, as defined under Article 8(1), include 'the coordination of gathering and dissemination of relevant or essential information in [...] emergency situations' and 'the planning and coordination of supervisory activities [...] in emergency situations'. This is without prejudice to the exercise of national competences and, accordingly, the role of other relevant authorities as crisis managers. However, the ECB considers that the very general clause of the last paragraph of Article 9(1) may not be helpful in

supporting the role of the coordinator in such situations as it may seem to be incompatible, in particular, with the tasks relating to 'emergency situations'. Nevertheless the ECB welcomes the assignment of such role to the coordinator, since this follows in particular the recommendations of the Economic and Financial Committee Report on financial crisis management. In this context, the ECB also recalls that the report recommends that 'in a crisis situation, all authorities likely to be involved should be informed in a timely manner'. This would include, in the terms of the EFC report, central banks and overseers of payment systems. The ECB would therefore reiterate that the role of central banks in the pursuance of financial stability would warrant the communication by the competent authorities and the coordinator to central banks, also in a crisis at the financial conglomerate level.

13. Fourthly, the cooperation and exchange of information between competent authorities. The ECB welcomes Article 9 of the proposal. The ECB interprets Article 9(1) as setting out mandatory obligations of the competent authorities to cooperate and share information, both generally and in specific instances. The ECB also welcomes sharing of information both on request and at the initiative of a competent authority itself. The ECB is therefore of the view that there should not be any constraints on cooperation and information sharing among the competent authorities of the regulated entities of a given financial conglomerate. As already mentioned above with regard to crisis management, the ECB considers that the scope of the last paragraph of Article 9(1) is too broad in the context of the mandatory provisions of the same Article 9(1). While the ECB recognises the need for flexibility in the relations between competent authorities, particularly with regard to the pursuance of their respective institutional mandates, it also believes that such flexibility may be achieved in practice in the context of the arrangements that will be established between the competent authorities.

14. Fifthly, the reference in the proposal to central banks and the Eurosystem. The ECB welcomes the reference, under Article 9(1), that 'the competent authorities may also exchange information with the following authorities as may needed for the performance of their respective tasks, regarding regulated entities in a financial conglomerate, in line with the provisions laid down in the sectoral rules: central banks, other bodies with a similar function in their capacity as monetary authorities, and where appropriate other authorities responsible for overseeing payments systems'. The ECB understands that this provision removes any possible legal impediments at Community level to supervisory information-sharing regarding financial conglomerates between the competent authorities, independently of their sectoral responsibilities, and central banks and payment systems overseers. In this connection, the ECB would first like to address a question of terminology. On the one hand, all the monetary authorities based in the European Union are central banks, as it is the case both in practice and under the Treaty in the context of EMU. The monetary authority for 12 Member States is the Eurosystem. On the other hand, the central banks of the Member States and the Eurosystem are also the only authorities in the Community responsible for overseeing payment systems. The Memorandum of Understanding on cooperation between payment systems overseers and banking supervisors in stage three of economic and monetary union ([5]) fully reflects this framework. The ECB would like therefore to clarify the abovementioned paragraph of Article 9(1) by rewording it as follows: '[...] central banks, the European System of Central Banks and the European Central Bank'. The reasons to include the ESCB and the ECB are twofold. First, since the establishment of the Eurosystem, the exchange of information with the central banks of the Eurosystem involves a cross-border dimension that is not yet acknowledged in the sectoral directives. Secondly, information conveyed to a central bank of the Eurosystem may be shared among the central banks of the Eurosystem. The ECB considers that the wording in the proposal would only further consolidate outdated concepts. In this regard, a recital in the proposal acknowledging the establishment of the European System of Central Banks and the European Central Bank would be welcome.

15. Furthermore, the ECB notes that the reference in Article 9(1) to the exchange of supervisory information with central banks may serve as an acknowledgement of the contribution by central banks to the prudential supervisory framework for financial conglomerates. The ECB would like to emphasise that the monitoring of risks inherent in the operations of large and complex multinational institutions is of direct concern to central banks. The central banks' traditional focus on systemic risk, together with their knowledge of money and securities markets and market infrastructures and their function in the oversight of payment and settlement systems, places them in a unique position to identify threats to the stability of the

financial system. In this context, supervisory information sharing with central banks will contribute to the monitoring and pursuit of systemic stability in the Community. Moreover, taking into consideration that the aim of the proposal is to consider the systemic risk of financial conglomerates at Community level, the ECB considers that also the euro-area perspective becomes particularly relevant. The behaviour of large and complex financial groups is likely to affect money and capital markets, as well as payment and settlement systems, well beyond domestic borders. In this context, the network of central banks of the Eurosystem may provide improved monitoring of risks to financial stability in the single currency area.

16. Sixthly, the comitology procedure. The ECB welcomes the proposed comitology procedure, under Articles 16 and 17, which aims basically to incorporate market and legislative developments in the main concepts on which the proposal is based, as well as to ensure their uniform application. The establishment of a Financial Conglomerates Committee is therefore a key element of the proposal. The ECB welcomes the proposed approach, which recently was given a new impetus by the report of the Committee of Wise Men on the Regulation of European securities markets. It should be borne in mind however that the legitimacy of comitology procedures should rely not only on their technical feasibility but also on appropriate safeguards for transparency and the prerogatives of the relevant Community institutions and bodies. The ECB would also recall the conclusions of the Committee of Wise Men on the need to devise a Community regulatory framework that is flexible and swiftly adaptable to changing needs. In this context, the ECB underlines that supervisory cooperation on the convergence of supervisory practices and the implementation of the proposed Directive, particularly as regards the main features of cooperative arrangements among the competent authorities, should be a main element in the Community's regulatory process for financial conglomerates. A periodical mapping exercise of financial conglomerates would also be helpful.

17. This opinion shall be published in the *Official Journal of the European Communities.*

Done at Frankfurt am Main on 13 September 2001.

The President of the ECB
Willem F. DUISENBERG

(1) OJ L 126, 26.5.2000, p. 1.
(2) Communication from the Commission to the European Parliament pursuant to the second subparagraph of Article 251(2) of the EC Treaty concerning the common position of the Council on the adoption of a Directive of the European Parliament and the Council amending the Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) with a view to regulating management companies and simplified prospectuses (COD(1998) 0242).
(3) OJ L 193, 18.7.1983, p. 1.
(4) OJ L 168, 18.7.1995, p. 7.
(5) ECB press release of 2 April 2001, memorandum of understanding on cooperation between payment systems overseers and banking supervisors in stage three of economic and monetary union.