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Position of the European Financial Congress[1] in relation to the European Commission's consultation document on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate[2]

Methodology for preparing the answers

The answers were prepared in three stages:

Stage 1

A group of experts including more than 70 specialists were invited to participate in the survey. They received selected extracts of the consultation document as well as the consultation questions in Polish. The experts were guaranteed anonymity.

Stage 2

The Gdańsk Institute for Market Economics[3] received 17 opinions from key financial market institutions in Poland and from individual experts. All the responses were collected, anonymised and presented to the experts who took part in the consultations. The experts were asked to mark in the other consultation participants' opinions the passages that should be included in the final position as well as the passages they did not agree with. Experts could also adjust their positions under the influence of arguments presented by other experts that they had not known previously.

Responses were obtained from experts representing:

- universal banks,
- auto loan companies,
- insurance companies,
- regulatory bodies,
- consulting firms and
- the academia.

Stage 3

On the basis of the responses received, the survey project coordinators from the European Financial Congress prepared the final version of the European Financial Congress's answers.

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[1] European Financial Congress (EFC – www.efcongress.com). The purpose of the regular debates held within the EFC is to ensure the financial security of the European Union and Poland.

[2] http://ec.europa.eu/finance/consultations/2016/financial-conglomerates-directive/docs/consultation-document_en.pdf

[3] Instytut Badań nad Gospodarką Rynkową (IBnGR) – the first independent think tank in Central and Eastern Europe, founded in 1989 by a group of economists associated with the democratic opposition and the "Solidarity" movement.

Answers of the European Financial Congress to the consultation questions[4]

Question 1(a):

How successful has FICOD been in identifying the right entities and activities to fall within the scope of the Directive? Has there been any lack of legal clarity and/or predictability about what entities and activities fall within the scope of FICOD affected, and if so, has that had any impact on: (i) risks to financial stability; (ii) the level playing field; and (iii) the level of protection of creditors and policyholders?

The Directive as it currently stands is not sufficiently successful in identifying the entities to fall within the scope of supplementary supervision. This creates risks to financial stability, to the level playing field and to the level of protection of creditors and policyholders.

Every financial activity needs to be supervised. This applies in particular to entities performing activities similar to those of banks, insurance undertakings, brokerage houses, investment funds/asset managers etc., which are currently not, or are insufficiently, supervised. Loan companies, debt collection agencies and hedge funds should, therefore, be subject to supervision.

In order to better reflect risks posed by conglomerates to financial stability and to improve the level of protection of creditors and policyholder, it would be advisable that ancillary insurance service undertakings, SPVs, pension funds and shadow banking entities be covered by the Directive.

It may be questioned why special purpose vehicles (SPV), which are used in particular for structured transactions, are excluded from regulation. Such transactions are not common on the Polish market and, therefore, the number of such vehicles, and the risks they pose, do not seem to be significant. However, considering the EU market as a whole, the experience of the financial crisis shows that it would be recommended to place such entities under control and ensure proper risk management.

In its present form, the Directive places too much emphasis on regulated entities, regarding them as the sole threat to the financial stability of conglomerates. Meanwhile, ancillary financial services undertakings and unregulated entities are disregarded, even though they are playing an increasingly important role in modern conglomerates. For example, it is becoming a widespread practice to set up separate entities within groups and task them to provide other group members with IT services. Debt collection undertakings are similarly spun-off to take over part of banks' loan portfolios.

Furthermore, special attention needs to be paid to undertakings providing regulated entities with business continuity services or with access to infrastructure, since their supervision is critical from the viewpoint of the level of risks to a financial group and the security of assets entrusted by clients.

In this way, some of the risk are transferred away from regulated entities, and thereby outside the scope of the Directive, but not away from the group. Therefore, while the risk is still there, it is no longer subject to as restrictive rules of management and monitoring. This negatively affects the risk of financial stability of conglomerates, and hence the level of protection of

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[4] The questions were selected from a broader pool of questions provided in the European Commission's consultation document. The original numbering has been preserved.

creditors or policyholders. It should also be noted that regulatory gaps pave way for a sort of profitability engineering both at the level of a conglomerate and at the level of its constituent entities. This may have negative consequences for the level playing field in the market Intra-group transactions (particularly those between countries) and transfer of risks outside an area protected by regulation may be used as a means to artificially improve the situation and artificially reduce costs of a regulated entity forming part of a conglomerate. As a result, it will be able to continue its inefficient, unprofitable or excessively risky operations while still pursuing the goal of expanding its customer base at the cost of safely operating companies in which no such transfer takes place.

Insurers increasingly often form part of non-financial groups and, therefore, it would be advisable to take into account their specific regulatory and security requirements. This would contribute to increasing the level of stability of the financial system while creating a more level playing field.

While the idea of increasing the stability and security of the financial sector is, in itself, reasonable, the Directive suffers from generalisation and vagueness in defining the concept of a financial conglomerate and of a mixed financial holding company. The definitions as currently worded in the Directive will allow ownership structure to be designed in a way that will enable some players to, by and large, avoid an extended regulatory oversight, and thereby improve their competitiveness and market position.

The definition of eligible entities is not precise. The key is the phrase "the most important sector". It can be interpreted in many, mutually opposed, ways, e.g. as the largest assets, the largest source of profits, the largest liabilities, capital allocation, risk accumulation, etc. This makes it open to individual interpretation.

In identifying financial conglomerates, it is also necessary to take into account what is known as prudential consolidation, which affects the risk profile and the integration of risk management processes at group level within the meaning of prudential consolidation.

Unless specific (qualitative and quantitative) criteria for the identification of a financial conglomerate are clarified, there is a risk that risks will be transferred away from a supervised area to unsupervised areas, thereby increasing the level of risk implied by groups that could be considered a financial conglomerate. This contributes to increasing risks to the financial stability of individual Member States, decreasing the level of protection of creditors and policyholders and reducing a level playing field. The Directive fails to adequately identify entities and areas of activity that should be subject to supplementary supervision. To this end, however, it would be necessary to significantly increase the professional competence of supervisors in intersectoral terms.

The scope of the Directive should be regularly expanded to include further entrants to the financial market, particularly fintech institutions, purely online institutions (e.g. e-currency exchanges) and payment institutions. In view of their increasing popularity and tendency to merge into groups, there is a risk that the stability of the financial sector will be threatened from an unexpected corner. Furthermore, high-technology institutions often operate outside a strictly defined legal framework. Companies from other sectors increasingly often engage in financial activities (e.g. Google or Facebook). Further risks come from the fact that a majority of these institutions are not subject to the CRR/CRDIV and not all banks fall within the scope of BRRD regulation. Compliance with the principle of a level playing field must, at the same time, be kept in mind as one of the cornerstones of the European financial market and the one

intended to ensure that institutions are not discriminated against on the financial market.

Question 2(a):

Mixed financial holding companies, financial holding companies and insurance holding companies fall within the scope of FICOD and in particular a capital requirement is imposed at that level of the group. However, supervisory authorities may not have direct powers of supervision over those holding companies such that they can require those holding companies to change their capital structure. Has this had any impact on the effectiveness of FICOD in identifying and managing group risk?

The lack of direct instruments and powers of supervision to require holding companies to change their capital structure clearly has a negative impact on the effectiveness of identifying and managing risks posed by those companies.

The provision of supervisory authorities with the necessary supervisory tools is crucial for the effectiveness of supervision. This applies both to the powers to collect relevant reporting data and to the powers to issue recommendations to supervised entities. The inclusion of financial conglomerates within the scope of supplementary supervision will be meaningful on the condition that supervisory authorities are equipped with the necessary tools. Otherwise such supervision this will be ostensible. Therefore, when considering the advisability of placing further entities under supplementary supervision, it is first of all necessary to determine whether the supervisor will be able to exercise oversight in an effective manner.

While the identification of risks created by mixed financial holding companies, financial holding companies and insurance holding companies does not seem problematic, the provision of the regulator with appropriate tools to restore law and order is a condition *sine qua non* for the proper operation of the regulation. Therefore, in addition to the laconic provision in Article 17 (namely that competent authorities shall have the power to take any supervisory measure deemed necessary in order to avoid or to deal with the circumvention of sectoral rules by regulated entities), the Directive should address in more depth matters such as non-compliance with its provisions, penalties and supervisory measures to enforce obligations.

On the other hand, it should be noted that in order for supervisory authorities to enforce changes in the structure of a group of holding companies, it is necessary to clarify the standard on how to design a group so as to minimize risks. Considering the complexity of groups as they currently exist, it is not possible to address all options of their design. Yet it is rather risky to leave such powers entirely to supervisors, as this exposes owners engaged in supervised activities to an unquantifiable risk of carrying out difficult-to-accept changes required by supervisory authorities. As a rule, it is advisable to design regulations in such a way that it is clear what a supervisor regulating the level of systemic risk can expect from entities that are part of financial holding companies, while providing the supervisor with a wide range of instruments to deal with the particular issues depending on how the current and future market conditions evolves. The absence of regulatory instruments giving a say on the capital structure reduces the effectiveness of the supervisor's efforts to identify and, above all, manage risks before the group's situation nears the point of being unsatisfactory.

If focus is placed solely on the group's capital requirement, i.e. on a single metrics, incentives are weakened for sound risk management and monitoring in relation to the individual group members. This is due to the fact that instead of allocating capital in proportion to the level of risk generated, it is sufficient to maintain total capital to cover overall group risk. If financial

problems arise within the group, this capital will be used in the order in which an entity is losing its financial stability rather than being allocated in proportion to the actual share it has in overall risk. Unless supervisory authorities have the right tools to enforce a possible change of the capital structure, the direct link between sources of risk and the capital to cover that risk will disappear and the instrument itself will prove to be ineffective.

Supervisory authorities may establish an entity within the group that will be responsible for risk control and compliance with regulations/recommendations in relation to capital structure, as well as enforce performance of these obligations by such entity (parent company). Such a solution would be operationally simpler to implement and would not require complex and costly organizational changes. At the same time, it would be important to introduce uniform rules in all Member States.

Question 2(b):

Other unregulated, non-financial entities (and their activities) that are relevant to the risk profile of the financial conglomerate are not included within the scope of supplementary supervision - for instance mixed activity holding companies are excluded. Has this had any impact on the effectiveness of FICOD as a tool to identify and manage group risk?

The fact that other unregulated financial entities (and their activities) that are relevant to the risk profile of the financial conglomerate are excluded from the scope of supplementary supervision affects the effectiveness of identifying and managing risks created by those entities; however, they should not be crucial to the risk profile of the financial conglomerate.

Mixed conglomerates, whose financial assets are significantly higher than those of purely financial companies, are currently outside the scope of regulation.

The European legislator’s exclusive focus on regulated entities would have negative effects in the long term, which would be evidenced in particular by attempts to transfer risk to companies excluded from supplementary supervision. It would then hinder effective supervision and the proper performance of obligations. It should be borne in mind that these are often companies of key importance for the proper operation of the entire financial conglomerate; one example is provided by entities from the IT sector.

In modern conglomerates, risks are beginning to increasingly accumulate in non-financial, unregulated entities (e.g. shared financial, maintenance and IT services for groups, based in a country chosen for, e.g., tax reasons). Exclusion of such entities from the scope of supervision would mean that risks present in a conglomerate would be understated and so would be the capital needed to protect the interests of creditors and policyholders.

Due to insurers’ regulatory requirements, some of the risk management standards are usually carried over. This is, however, a decision groups make on a case-by-case basis. Risk is, therefore, analysed only from the viewpoint of a regulated company. This could potentially be a gap in risk identification. However, any imposition of additional requirements on companies which do not currently fall within the scope of regulation would need to be consistent with the principle of proportionality so as not to create excessive regulatory burdens where they are not needed.

In order to prevent, or manage, a crisis situation, supervisors would additionally need to be equipped with instruments that would be effective also with regard to unsupervised activities. To this end, an approach could be applied in which supervised parent companies would identify and assign risks to specific entities within the group. This would allow the identification of

entities (other than supervised entities) that generate a certain level of risk for the group. Using defined supervisory tools, it would then be possible to make adjustments to the group's financial activities in order to prevent the level of risk from exceeding regulatory thresholds, including exerting an influence on unregulated entities which have been identified as the source of a material level of risk for the group.

The question of whether effective risk control tools can be developed for this type of entities is another matter to consider. Unregulated, non-financial entities (and their activities), should not, however, be crucial for the risk profile of financial conglomerates.

A decision on whether or not a given entity should fall within the scope of supplementary supervision is currently determined by organisational and formal considerations rather than by the actual level of risk associated with its activities or the direct or indirect impact the entity exerts on the level of risk of other entities. For this reason, supervision should be extended to entities which have an impact on the group's risk, whatever their place within the group. It would, therefore, be advisable to consider replacing the organisational criterion with the risk assessment criterion.

Question 2(c):

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

The costs involved in including such entities and activities in supplementary supervision, including legal and operational, are difficult to estimate but can be expected to be considerable, depending on the scope of supervision and the risks covered. The advisability of including such entities remains an open question.

The costs and legal and operational consequences could be severe and the effectiveness of such supervision by financial supervisory authorities could be insufficient. First of all, the expansion of the subjective scope of the Directive would make it necessary to provide additional personnel and financial resources.

The costs involved in including other, previously unsupervised entities would probably be very high, not least because of the cost of capital that would need to be additionally maintained or additional human resources required to exercise supervision in an operational sense (both on the part of groups and on the part of the regulator). Therefore, it seems reasonable to adopt appropriate materiality thresholds above which supervision would be exercised.

High costs would also result from the need to integrate legal regimes and IT systems and to revise supervisory procedures.

The question of how to organise supplementary supervision for that category of entities poses a significant challenge. Is it at all possible, in practical and legal terms, to include non-financial within the scope of supervision, especially if some of them are located in a third country? Such supervision would entail that they would be subject to reporting, capital requirements, leverage ratio, or the requirement to prepare recovery plans. In the case of, for example, a processing or outsourcing centre this would be difficult to implement.

A question, therefore, arises whether the inclusion of activities of non-financial entities within the scope of supervision would represent an effective use of resources and would not cause an unreasonable regulatory burden. The answer depends on the scope of supervision (information

or decision-making supervision), the type of an entity, the regulatory environment and granted supervisory powers.

Question 3:

To what extent are the quantitative threshold rules in FICOD:
(a) clear and effective (in terms of, for example: drafting, parameters used to calculate them *e.g.,* assets and capital requirements, accounting treatment of assets across various sectors, are indicators that apply to all relevant sectors in a financial conglomerate equivalent, do all financial institutions that are part of a banking group have solvency requirements);
(b) predictable for the industry; and
(c) create costs either for supervisors or entities? Are any of the costs unnecessary?
(d) is the application of the thresholds transparent?

The quantitative thresholds proposed in the Directive do not appear to create significant costs, are basically clear, predictable and transparent, yet this does not prejudge their effectiveness. An alternative solution could be to make the inclusion within the scope of supplementary supervision dependent on risks generated by these entities to the financial system.

Supervision of conglomerates has a complementary nature. The aim of supplementary supervision is to identify and mitigate additional risks arising from intersectoral interactions, which can go unnoticed by sectoral supervisory authorities. Supplementary supervision should not duplicate the work of sectoral supervisors. The findings and assessments made by sectoral supervisors should form a starting point for supplementary supervision.. An assumption should also be made that, save for exceptional situations, supervised entities are healthy and meet the required standards. If this is not the case, the task of remedying the situation of supervised entities and bringing them into compliance with standards and legal requirements should be the responsibility of sectoral supervision rather than supplementary supervision. Its task should be to assess additional risks, which may stem from intersectoral interactions but also from interactions between supervised and unsupervised entities in the same sector of the financial market. The actual status quo of the particular entities, regardless of whether or not the applicable standards (if any) are met, should be a starting point for the assessment of additional risks.

Financial conglomerates are structures that are much more complex than the individual components of a conglomerate. Therefore, in practice, they differ significantly from each other. For this reason, it is difficult to specify conditions which must be fulfilled in order for a diverse group of entities to be considered a financial conglomerate. In particular, a threshold for inclusion within the scope of supplementary supervision may differ for each conglomerate. Therefore, the threshold would need to be established at a sufficiently low level to apply to all conglomerates, or at a higher level, leaving it within the discretion of the supervisor to include conglomerates within the scope of supplementary supervision if, in the judgment of the supervisor, they generate risks justifying the adoption of supplementary supervisory measures. The assessment of the fulfilment of prudential standards by each of the entities forming part of a conglomerate should be regulated at the level of sectoral legislation.

Considering that conglomerates are characterized by a high degree of complexity and diversity of structures, and parent companies may be unsupervised and unregulated, it is very difficult to establish specific criteria for inclusion. It is, therefore, necessary to leave the final decision to the discretion of the parent company supervisor in consultation with the local supervisor.

Each reporting requirement creates costs for supervisors and supervised entities. In the case of quantitative thresholds which decide whether or not a group is to be included in supplementary supervision, these costs can be expected to be low, as such thresholds make use of easily measurable indicators. Given the scale of those costs, there seems to be no reason to reduce them.

Every financial activity targeted at external clients needs to be supervised. Different entities, particularly those currently operating on an unregulated basis, may easily evade the above-mentioned thresholds by recourse to the use of various types of mechanisms. As the solution currently in place leaves much open to interpretation and doubts, a question remains whether inclusion within the scope of supplementary supervision could be based on the criterion of risk generated.

Quantitative thresholds, which trigger supplementary supervision, are transparent; it is sufficient to compare the calculated ratio with the threshold value. If the thresholds are supplemented with discretionary decisions of supervisory authorities, the transparency of the approach will be preserved if supervisors state reasons for their decisions.

The quantitative thresholds set out in the Directive are simple and predictable, and thus do not create significant additional costs either for supervisors or for entities. This also contributes to their transparency, as they apply throughout the European Union. This does not, however, automatically make them effective. To be effective, a threshold needs to be adequate to the goal to be achieved, namely the financial security of groups.

The establishment of thresholds at fixed levels is debatable. This similarly applies to the application of parameters (e.g. capital requirements) which are not entirely equivalent between the sectors. However, the biggest drawback of this approach is that it is focused solely on financial institutions and disregards other entities, which distorts the perception of the actual risk concentrated in the activities of a given conglomerate.

The rules of identifying financial conglomerates are generally clear with the exception of the issue of whether or not intragroup transactions are to be taken into account in the calculation of the balance sheet total and capital requirements. On the one hand, such transactions are relevant to the financial sector, but on the other it would appear more advisable to omit them. Moreover, the inclusion in the calculations of unregulated financial entities to which no prudential requirements apply will cause inconsistencies in the identification of financial conglomerates.

The simplicity of the rules, and thereby ease of application, are the advantages of the current proposal. The type of valuation (at book value vs market value) is a matter for consideration.

Question 4:

Considering the quantitative threshold rules in FICOD, has the effectiveness of FICOD in identifying and managing group risks been affected to any extent by the fact that thresholds are not risk based?

The fact that thresholds are not risk based negatively affects the effectiveness of the Directive in identifying and managing group risks. The incorporation of risk assessment would surely allow for better alignment of available supervisory tools to the risk scale and profile of financial conglomerates.

Given a rather arbitrary definition of thresholds, differences in prudential requirements for the particular sectors, as well as differences between entities forming part of conglomerates, identification based solely on thresholds, without taking into account the specific features of a conglomerate, must be subject to considerable inaccuracy. The identification process should also take into account risk factors, but risk assessment cannot be described by means of a mathematical procedure and will require recourse to supervisory assessment.

The lack of thresholds could be a better solution because it would provide a rationale for the use of company figures in the risk analysis. Companies can generate a high risk even without a high balance sheet total (e.g. reputational risk).

Reliance on subjective criteria could be a prerequisite for proper risk assessment. It is financial activity widely understood that gives rise to considerable risks in both purely business terms (operational) and in intangible terms (reputational). To recognise it *de jure* as an activity with a significant risk profile would mean that if at least one of the entities forming part of a conglomerate or a holding company carried out such activity, the whole group would be subject to supplementary supervision, which would discourage attempts to circumvent prudential rules.

Financial conglomerates are usually groups that are led by regulated entities. In these cases, materiality thresholds are based, *inter alia*, on solvency requirements, which in part addresses the issue of group risk assessment. Moreover, competent authorities may choose the off-balance sheet criterion instead of the balance sheet total criterion, which makes it possible to base risk assessment on, for example, quantitative or qualitative criteria.

On the other hand, however, a situation may easily be imagined where the presence of banking sector entities in the group is insignificant (within the meaning of the above-mentioned provisions) compared to unregulated entities, but they have a large share in the banking sector of a given country. The loss of financial stability in such a group would then bring forth significant negative consequences for the entire banking sector. Yet the group will not be subject to supplementary supervision and the actual risk will not be subject to proper control.

It should be noted, however, that in the case of unregulated companies forming part of a group, reliance on risk as the sole criterion of inclusion within the scope of supplementary supervision may pose significant difficulties (e.g. in outsourcing entities where human capital is the main asset).

Question 6:

To what extent has current national discretion to use waivers impacted: (i) financial stability; and (ii) the level playing field, both within Europe and internationally?

In principle, the discretionary nature of exemptions at the level of the Member States may affect both financial stability and the level playing field. At the same time, however, it may be regarded as a factor enhancing effective supervision.

Generally, the focus of the EU legislation on financial market is shifting away from waivers and discretions towards maximum harmonisation (e.g. the Five Presidents Report or plans create the Capital Markets Union). This is intended to ensure a level playing field for the sector's players both locally, within the EU, and globally.

The provision of national legislators with a considerable degree of freedom in excluding certain entities or group of entities from the scope of the Directive entails a significant risk of

disrupting financial stability, as well as of weakening the competitive position in micro and macro terms. The current regulation in the form of a directive (rather than a regulation) creates a natural opportunity to exert pressure on and lobby local parliaments to adopt legislation that will favour national players and will relieve them from the burden of increased regulatory requirements. In the short term, this will probably benefit both conglomerates and consumers. Nevertheless, the championing of what may be called “national” interests is not always consistent with the global nature of the business an entity conducts and the potential effects that, for example, its bankruptcy or unethical conduct may have. No such developments would take place if there was no such arbitrariness of criteria and if there was a proper exchange of information.

The discretionary powers involved in some arrangements always carry a risk of certain injustice or incomparability. The impact of such discretionary arrangements can be very significant, both in terms of financial stability and a level playing field for groups. Many of those groups have an international dimension. In such a situation, the differences in rules governing their supervision will create an incentive for a sort of arbitrage – by concentrating more risky activities (and therefore those requiring more capital) in countries where regulations are less restrictive (to avoid excessive oversight). However, driven by a desire to optimise costs/capital, such concentration will result in undermining the adequacy of risk and capital, which in the long run will be detrimental to the financial stability of groups. Similarly to the use of tax havens, it will also negatively affect the level playing field in the market.

On the other hand, the discretionary nature of waivers is an indispensable feature of the Directive. It may also be regarded as a factor that enhances rather than weakens supervision. Assuming the rationality of supervision, the aim of which is to protect deposits and maintain the stability of financial markets, properly functioning supervision will be guided by the goal of ensuring security of entities forming part of a conglomerate and the financial stability of the state.

The discretionary nature of waivers from the Directive applied at the Member State level poses a challenge for the supervision of conglomerates, particularly those operating in an international arena. However, the lack of an option to adapt criteria in quantitative and subjective terms may result in the inability to include certain entities within the scope of the Directive.

The discretionary nature of waivers will always create a risk of distorting a level playing field for similar entities. If the special discretionary powers granted to the coordinator were exercised only in exceptional circumstances and were well motivated, it seems that their impact on financial stability would not be significant. If, however, they become a market making tool, financial stability could be undermined not only because of weakened prudential requirements, but also because of regulatory uncertainty and unpredictability.

In normal situations, waivers undermine the level playing field in the market; however, in crisis situations, the state should be able to intervene and that is why such arrangements are valuable.

Question 7:

Are the rules in FICOD (including Annex 1) clear as to what capital adequacy at the level of the conglomerates means and what calculations are required from a financial conglomerate? Are the relevant entities included for the purpose of calculating the capital adequacy requirements?

To ensure regulatory consistency in the EU, basic regulations on the financial market should be consistent with each other and complementary.

The rules in the Directive are clear as to what capital adequacy at the level of the conglomerates means but are vague and need to be clarified with regard to the inclusion of entities within the scope of supervision and the calculation of the capital adequacy requirements.

On the one hand, the regulator intends to unify requirements both at the individual and consolidated levels, yet, on the other hand, one should bear in mind the sectoral provisions which may set out entirely different requirements in relation to the issue of adequacy. This is due to the differences between banking, investment and insurance industries: it is difficult to imagine that the capital adequacy of, for example, banks could be applied directly to brokerage houses.

As a result, the rules are not clearly defined and leave much to the discretion of authorities of the conglomerates and the competent supervisory authorities. In this situation, it is indeed difficult to achieve the comparability of capital adequacy levels of conglomerates. It should, however, be considered whether such comparability would provide meaningful information and whether it should constitute the goal of supplementary supervision. It is important that the requirements are met at the level of each entity or at the sectoral level. The level of capital adequacy of a conglomerate will depend on the choice of a method. However, given the huge differences between the conglomerates, their composition and structure, the adequacy of individual conglomerates is hardly comparable.

Information on the level of adequacy is important mainly for the conglomerate's supervisor and, therefore, it should be up to the supervisor what method to choose. At the same time, it is important to keep in mind that the comparability of the capital adequacy of a conglomerate does not provide any meaningful information if these requirements are met at the sectoral level or at the level of the individual entities. If it is assumed that maintaining capital adequacy is primarily intended to serve the interests of the conglomerate itself, it is necessary to continue sanctioning the existence of several methods and leave it to the discretion of supervisory authorities to choose the best method, taking into account the structure and risk factors of a given conglomerate.

It must be further considered whether only entities with defined levels of capital adequacy (in practice these would be supervised entities) should be included the calculation of capital adequacy requirements, or should we include also entities offering additional insurance services, SPVs, pension funds and shadow banking entities. The fact that the regulatory approach should be holistic and address the risks implied by unregulated entities forming part of a conglomerate with a significant risk profile argues for the choice of the latter approach.

Question 8(a):

What is the added value of the FICOD capital adequacy calculation, taking into consideration that each financial sector in the financial conglomerate is subject to capital adequacy rules at the sectoral level?

The FICOD capital adequacy calculation enables taking into account the risk of a conglomerate as a group, which is not simply a sum of risks of the individual entities forming part of the conglomerate.

While the individual entities of the group may not generate certain types of risk, such risks may occur within the group as a whole as a result of interactions between entities from different sectors, as well as the concentration of certain risks.

In the case of a conglomerate, the sectoral capital adequacy calculation does not take into account links between entities forming part of a single conglomerate but originating from different sectors. It is even possible to imagine a situation where the capital adequacy requirement is met in each sector but is not satisfied at the conglomerate level. The calculation and limitation of capital adequacy at the conglomerate level makes sense if it leads to an increase in the capital requirement for the conglomerate to reflect an increased risk resulting from the scale of operations, links within the conglomerate and the contagion effect, as well as prevents the multiple use of capital to cover risks of various entities.

The capital adequacy calculation at the financial conglomerate level thus ensures both an adequate level of own funds to cover capital requirements of all sectors forming part of the conglomerate, as well as full coverage of the group’s risks through specific recognition of equity interests in the group. The added value refers to the allocation of capital to risks that are not identified through the standard approach to capital adequacy requirements, beyond sectoral requirements. In addition, the ability to compensate for the deficit of own funds between the group’s entities is possible only in the absence of formal obstacles to their transfer, which is essential for effective risk management at the level of the group and its individual entities.

Another added value of the Directive is that it harmonizes actions in Member States where the financial supervision is not integrated but sectoral. Furthemore, the existing and planned prudential regulations (including CRDIV/CRR and Solvency 2) are adapted to the specific nature of activities in the specific sectors and may form a basis for the capital adequacy calculation of a financial conglomerate. This factor would have a positive impact on the coherence of sectoral regulations and those concerning conglomerates.

Question 9:

FICOD does not contain any explicit provisions allowing supervisors the discretion to require additional capital to be held against specific cross-sector risks in the financial conglomerate. Has this had any impact on the supervisory effectiveness of FICOD?

In order to exercise proper control of the financial sector generating risks to financial stability, supervisors must be equipped with adequate instruments. National regulators should be provided with the powers and tools that will allow them not only to maintain but also effectively exercise supervision and enforce regulations. The lack of such powers and tools may lead to a situation where requirements are either excessive or underestimated.

The monitoring of institutions for the provision of adequate capital should form one of the pillars of prudential supervision. The development of new lines of business within the financial conglomerates is conducive to the creation of new risks which – in the case of failed decisions – should be remedied by the conglomerates and should not give rise to negative consequences for the clients. Conglomerates by their very nature can have a domino effect. The bankruptcy of a single conglomerate (or one of its companies members) may cause the crisis to spread to other groups. It is, therefore, important to provide sufficient capital so as to properly cover and secure each of the activities carried out and the risks they generate.

In accordance with sectoral regulations, supervisors are provided with powers to appropriately burden operations carried out in the particular sectors. However, while the capital adequacy calculation is well established and its design does not give rise to doubts at the sectoral level, it is difficult to clearly and correctly define it at the conglomerate level, at the junction of interrelated sectors. Therefore, the assessment of the capital adequacy of a conglomerate will depend on its structure, internal relations and organisation. In such case, it would be advisable that the conglomerate's coordinator be provided with sufficient freedom to be able to flexibly adapt the calculation to the specific features of the conglomerate.

It would be reasonable if the competent supervisory authorities could establish additional capital buffers for financial conglomerates. This would require the fine-tuning of the method of capital allocation within the group, particularly as regards the proportion in which the particular entities would be burdened with additional capital. At the same time, the host supervisor should retain a say on decisions on the amount of the requirement allocated at the conglomerate level, as otherwise this amount may not fully reflect the scale and risk profile of the local entity.

Question 12(a):

Have the FICOD rules on governance, risk management (including capital management) and internal controls contributed to sound governance in financial conglomerates and has there been an impact on the organisation of conglomerates?

The rules on governance, risk management (including capital management) and internal controls have created conditions for the improvement of the quality of owner supervision and may have an impact on the organisation of conglomerates, as well as constitute an essential tool for supporting the actions taken by supervisory authorities.

In this context, what is extremely important is the awareness of the legislator itself, who continuously emphasises and strengthens the importance of a proper and efficient organisational structure not only in the FICOD but also in other regulations (e.g. MiFID II).

The regulations themselves are quite general and need to be fine-tuned in terms of required elements of the risk management process, the minimum scope of the risk management process, internal controls and the management of significant risk concentrations.

The Directive envisages the appointment of a lead entity that will be accountable to the supervisor for proper management of the conglomerate, including risk controls, compliance with capital structure regulations and implementation of responsibilities in the group. This enforces a consistent approach to risk management, provides an additional "safeguard" for local risk functions and leads to the transfer of good management standards and experience from other markets.

Conglomerates differ in composition and organization to a much greater extent than homogeneous groups operating within a single sector of the financial market. For this reason, it does not seem advisable to further fine-tune the rules on the designation of the coordinator. This matter should be decided by supervisors on a case-by-case basis, taking into account the composition and organization of a conglomerate, with a particular focus on the actual rather than formal relationships between the entities and the question of which of them plays the leading role. It would, therefore, be advisable to put more emphasis on the qualitative nature of the rules to give the authorities which exercise supervision or supplementary supervision of conglomerates more flexibility in shaping those rules.

An analysis of the ownership structure of a financial institution is another issue which is relevant to risk management but which is also virtually ignored in the current legislation. Many problems, especially in large financial institutions, stem from the lack of large and stable investors (the shareholder structure is highly dispersed). This often results in excessively risky behaviours of their management boards, which tend to look for short-term gains and ignore long-term risks.

Question 13:

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

There are two different positions on the issue of resolution and recovery of financial conglomerates:

- there is no need to set up a rule that the conglomerate as a whole must be subject to resolution,
- the absence of a resolution framework for conglomerates constitutes the weakness of regulation.

The former advocates that resolution should be reserved only for banks forming part of a conglomerate rather than to all of its constituent entities. This position stems from the fact that the harmonised rules of resolution and recovery (BRRD) were designed primarily with deposit and credit institutions in mind. One of the goals is to prevent, or at least limit, the negative feedback between banks and the state, and to minimize the financing of that process with taxpayers' money. There seems, however, to be no need to set up rules of resolution for financial conglomerates, particularly considering that the process could be too complicated and thus ineffective. Banks have their own rules of resolution and, in most cases, operate as independent entities. The need, if any, for any of the entities forming part of a conglomerate to provide financial support should be laid down in the resolution plan of a banking group.

The opposite viewpoint claims that this should be one of the main supervisory tools to be used in the event of developments that may lead to the bankruptcy of a financial conglomerate. It should be noted that the financial system is functioning in a global environment and adverse events for one group may cause an identical effect for other groups (*vide* the financial crisis of 2008). We should always keep these lessons in mind and adopt regulations that will protect the market against similar negative implications in the future; resolution may be one of such safeguards. Due to the complexity of its structure, cross-border nature and the volume of transactions and assets, the resolution of a financial conglomerate requires a strong supervisor and harmonized actions of the supervisory authorities involved. A resolution framework is currently in force for groups but is missing for financial conglomerates; for this reason, there is an urgent need to implement such a framework.The key issue is to enable the detection of risks to the group's stability at a sufficiently early stage, as these procedures are triggered before the group becomes insolvent.The absence of a resolution framework deprives the supervisor of an effective tool for enforcement of the Directive, thereby significantly undermining its effectiveness. Furthermore, this may have a negative impact on the stability of the financial sector in emerging economies, as the poor financial situation of parent companies will be transmitted to the subsidiary level in a way that does not take into account the interests and

financial security of the country in which the subsidiary is located. To this end, it is necessary to set up rules on the bankruptcy of conglomerates (as a part of or a complement to the BRRD).
It should be noted that due to the scope of the BRRD, not all entities of the group would be subject to the BRRD and the bankruptcy of some of them would be governed by the general rules applicable to ordinary insolvency proceedings. This could lead to conflicts between the authorities in charge of the proceedings, expose creditors to unequal treatment and expose the companies to unjustified financial losses.

Question 14:

To what extent, if any, have the rules in FICOD on intra-group transactions and risk concentrations that empower supervisors to monitor intra-group transaction and risk concentration enhanced the supervision of financial conglomerates, taking into consideration that each sector is subject to its respective sectoral legislation?

The monitoring of intra-group transactions and risk concentrations at the financial conglomerate level appears to serve a different purpose than the monitoring of those aspects as part of sectoral requirements.

From the point of view of supervision of conglomerates, the rules on intra-group transactions and risk concentrations are extremely important, as they provide a picture of the conglomerate as a whole rather than of its individual entities or sectors.

Each sector of activity is subject to its own sectoral regulations. Such regulations focus only on the particular parts of the conglomerate and disregard interactions between them (both in terms of capital and risk). Compliance with standards in the particular sectors of the conglomerate does not, however, translate into the safety of the conglomerate as a whole.

Relationships between the entities (including those from different sectors) are very strong in modern conglomerates, which is why additional risks evolve and it is possible to underestimate the necessary capital. Therefore, intra-group transactions or those between a financial institution and its owner, as well as concentration risks, are a source of new/additional risks that may disturb the stability of the conglomerate. This risk exists regardless of whether or not the entity at risk is a regulated entity.

The supervision and monitoring of intra-group transactions, or the requirement to obtain the supervisor's approval for certain types of transactions, are intended to prevent transactions aimed at risk transfer. Another purpose is to detect transactions which are designed to circumvent sectoral requirements. For this reason, the overriding principles, at the FICOD level, are very important and useful in the business practice of companies and represent an important supervisory tool that supports sector-specific regulations.

The monitoring of intra-group transactions and risk concentrations based on the reports required by the Directive is an important source of information for supervisors and gives a fuller picture of what is going on within a financial conglomerate. Any solution to improve the control of this process will strengthen the supervision of conglomerates.

What seems to be important is that the coordinator verifies threats to the above-mentioned transactions at the conglomerate risk level (as opposed to a single sector); this seems to be essential in financial conglomerates which comprise unregulated entities.

The absence of a harmonised approach to intra-group transactions is an obstacle to full comparability of how supplementary supervision of financial conglomerates is exercised in the

European Union. It is necessary to continue efforts towards greater harmonisation. Such harmonisation should take into account the principle of proportionality and focus on significant intra-group transactions.

Question 15:

To what extent, if any, do you observe a difference in the treatment of banking-led and insurance-led conglomerates with respect to risk concentrations and intra-group transactions?

The Directive and the specific regulations allow the conclusion that there is a difference in the way the EU legislator approaches banking-led and insurance-led conglomerates.

This is evidenced by the differences in definitions, the group solvency calculation and the calculation of own funds. As regards the approach to risk concentrations and intra-group transactions, the type of a conglomerate may be relevant if it is necessary to use supervisory tools and impose sanctions on a conglomerate. The sectoral rules will then apply – and these are not identical for banking-led and insurance-led conglomerates.

It would be advisable to harmonize an approach to the identification of significant risk concentrations. In the case of the identification of significant intra-group transactions, an approach based on the capital adequacy of a financial conglomerate is used. This represents an attempt to harmonise the approach for the different sectors forming part of a financial conglomerate, subject to the aforementioned doubts regarding the capital adequacy of a financial conglomerate.

In the case of a financial conglomerate, there is a criterion of determination of significant risk concentrations (if, due to the exposure to a given risk, a regulated entity may incur a financial loss equal to or exceeding 25 % the equivalent of the solvency capital requirement applicable to that entity).

The specific features of transactions within insurance groups are reinsurance and the longer period of time it takes for an infection to spread and be diagnosed compared to transactions within banking groups.

Question 17:

To what extent has FICOD provided supervisors or Member States with tools and powers to address the risks which may stem from the new structures mentioned above?

There are two opposing positions as to whether the Directive provides supervisors and Member States with tools and powers to address the risks which may stem from new conglomerate structures in today's markets:

- the Directive largely adequately identifies risks and provides the right tools for the supervision of the new structures of conglomerates,
- the Directive is increasingly losing its validity and the tools it provides are not very effective.

The first of the above-mentioned positions argues that the Directive effectively determines the scope of supplementary supervision of regulated entities, as well as the rules of the supplementary supervision of capital adequacy and risk concentration. Transactions between companies belonging to the same group are subject to supervision. Internal control mechanisms

and risk management processes are defined. The Directive requires implementation in a manner adapted to the specificity of each jurisdiction. Supervisors and Member States have at their disposal adequate tools and powers. If financial entities originate entirely from the banking segment or the insurance segment, they do not form a conglomerate and there is no reason to introduce supplementary supervision. A similar situation occurs if the operations of the non-financial part generates much higher risks than the financial part. Therefore, in the case of a conglomerate in which new non-financial structures appear, they should be treated in a manner similar to that applicable to ordinary consolidated groups.

The alternative position argues that the EU legislation should follow market trends in the development of financial instruments and capital links between the financial and non-financial sectors. By defining a conglomerate solely from the perspective of financial entities, the Directive is increasingly losing its validity and the tools it provides are not very effective. In this situation, it is difficult to conclude with high probability that preventive and remedial measures are able to ensure the adequate enforcement of rights. Modern conglomerates shift weight away from financial sectors towards non-regulated sectors. Financial institutions often become a mere appendage, as is the case with the Tesco Group or the Ikea Group (and its Ikano bank). In these cases, the risk of financial entities is very often linked to the risks arising from trading activities of other entities, while the latter are completely disregarded. To conclude, at the current stage of the market development, the Directive provides supervisors and Member States with insufficient tools and powers to address the risks which may stem from new conglomerate structures in today's markets. The evolution of conglomerate structures calls for the revision of the proposals contained in the Directive.

Question 18:

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

Generally speaking, the Directive is quite clear on which institution should be the coordinator of supervision, while allowing the necessary flexibility for specific situations. The exception is the situation where the tasks of the coordinator are exercised by the competent authority of the regulated entity operating in the most important financial sector. The definition of the most important financial sector is not sufficiently precise.

The cooperation between home and host supervision is, however, worth noting in this respect. The problem of cooperation and enforcement of capital requirements, buffers or instruments at the consolidated level under Pillar 2 has been addressed in detail in the CRR/CRDIV. The solutions adopted therein and the methods of cooperation between home and host supervisors should be preserved for the sake of regulatory consistency.

First of all, supplementary supervision from the perspective of the parent company only is not sufficient to ensure early identification of risks and hazards.

Cooperation should in particular ensure the correlation of the strength of supervision with the risk level. This is because it is often the case that a subsidiary company is subject to local supervision rather than the SRM, yet it plays an important role for the entire group, even though it is a subordinate and not a parent company.

In addition, the consolidated accounts capture all the companies of the group, including non-financial and unsupervised ones. Such a direct link means that in the case of financial problems of a mixed-activity holding company, the funds of a financial company may suffer. The problem

is all the more relevant considering that, in extreme cases, such company may no longer meet the capital requirements, which will automatically, and without any fault on its part, trigger appropriate prudential mechanisms.

Furthermore, due to the lack of supervision of non-financial companies, the supervisor does not have an insight into the state of their finances, stability and the quality of the balance sheet.

Question 19:

To what extent does the identification of a subset of relevant competent authorities out of a group of competent authorities benefit or hinder supplementary supervision?

The identification of a subset of relevant competent authorities was intended to improve the operation of supplementary supervision and decision-making.

The limitation of the number of authorities allows for more efficient group supervision and improves decision-making. On the other hand, the exclusion of certain supervisory authorities, which were not deemed competent, from decision-making may constitute a negative effect.

All the countries, even those in which the relevant supervisory authorities are not included in the subset of relevant competent authorities, must be able to implement a supervisory policy on their own. Compliance with the ESA guidelines by supervisors, including the coordinator, should prevent situations in which supervisory authorities are unreasonably excluded.The proper and effective operation of supplementary supervision requires that all the entities involved in such supervision are aware of their powers and scope of operation.

In Poland, there are no domestic financial conglomerates but the national authorities supervise companies that are part of international, EBA-recognised conglomerates. The risks associated with the operation on the local market of an entity which is part of a conglomerate (and hence has financial, economic or legal links with that conglomerate and participates in losses or even bears the costs related to the bankruptcy or financial difficulties of another company of the group) are relevant to the local market and, therefore, supervision should remain the responsibility of the local supervisor. In addition to ensuring protection to other entities of the sector, this will allow for ongoing and thorough monitoring of the state of the company, early warning of and rapid response to risks, as well as will provide a variety of essential tools.

Question 20:

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

There is a difference of opinion on whether the Directive is effective in ensuring that supervisors can enforce compliance with the ultimate responsible parent entity in a financial conglomerate.

Compliance with supervisory recommendations is certainly easier if the parent entity in a financial conglomerate is a supervised entity. The Directive lays down the necessary requirements in this respect; however, these provisions are transposed to the national legislation and the actual impact depends on the transposition of the Directive. The concept of creating a harmonized approach in this area should be carefully considered in order to provide

local supervisors with the necessary freedom in pursuing the objectives in the light of local conditions and needs.

An alternative viewpoint claims that if a conglomerate is headed by an unregulated entity, the effectiveness of the Directive itself appears to be low. Furthermore, the main weakness of the Directive stems from its failure to provide the competent authorities with adequate tools that would allow them to effectively enforce compliance with financial conglomerates. The perfunctory statement on the necessity to use all available means (Article 17) is not enough. What is needed are the provisions defining behaviours that constitute a legal infringement, a list of penalties and measures to restore compliance, as well as the individuals and entities accountable to the supervisory authorities. Another important issue are the powers of the coordinator, which come down to the use of the measures and tools set out in the sectoral regulations (in relation to the lead entity). Such measures and tools are, by design, applied only to the selected part of a conglomerate and not to the group as a whole. Moreover, they differ for banking-led and insurance-led conglomerates. As a result, the supervisor is often unable to enforce optimal solutions (e.g. changes in the capital structure) that go beyond the scope of a given sector.

Question 21:

Please make any further comments on FICOD that you may have.

The role of non-financial, unregulated entities has been growing in many conglomerates along with the development of cross-border activities and outsourcing. Hubs, which are concentrated in a particular country or region and operate as service centres (accounting, information technology, settlement services, etc.) for the other entities of the conglomerate, are increasingly common. As their role grows, so does the risk they generate. However, under the legislation currently in force, such activities are not controlled, as controls target only regulated entities. It seems, therefore, that the regulations currently in force are increasingly outdated and require the adoption of arrangements that would take into account all types of entities and the appropriate valuation of their role and risks, as well as of the necessary capital. This should be accompanied by uniform, cross-sectoral powers of supervisory authorities so that they are able to enforce compliance with the Directive.

The frequency of the identification of financial conglomerates and the discretion of the coordinator in deciding whether supplementary supervision must be maintained for a group which no longer meets the criteria of recognition as a financial conglomerate call for a review.

The introduction of the supplementary supervision of financial conglomerates is expected to create a level playing field between insurers forming part of insurance group (regulated by Solvency II – where the provisions on group supervision apply) and of other conglomerates.

The Directive in its current form allows for cooperation of the competent authorities in the situation where the regulated entity is a member of a group which, in the opinion of the competent authority, qualifies as a financial conglomerate but cannot yet be identified as such in accordance with the Directive. This provision can provide a basis for proceeding with the identification of a conglomerate as part of defined identification exemptions. The provisions of the Directive would need to be revised as far as other structures of conglomerates in today's markets are concerned.

The design of additional supervision is problematic: the rules of identification of entities subject to such supervision are not transparent, the eligible entities are not defined with sufficient

precision and the supervisory tools are insufficient.A group may comprise more than one supervised entity (insurer, bank, investment fund, etc.). Different types of institutions may play the role of a parent company, and even that may not be easy to determine given cross-ownership of shares. In this situation, the Directive should state explicitly that, for example, every group which owns a regulated entity will itself become a supervised entity (as soon as it exceeds a certain threshold defined by participation in corporate governance). Likewise, a supervisory body should be clearly defined. The choice is simple if supervision is consolidated in a given country. If not, such body would need to be designated in a legal act (e.g. central bank). Cross-border supervisory cooperation is defined in other legal acts and reference to it would be sufficient. The Directive must explicitly provide supervisory powers over unregulated entities (impact on capital, etc.) if they control the financial entity.

Given the intrinsic conflicts of interest of nation states or groups of countries in relation to cross-border conglomerates, and also the early stage of implementation of the supervisory regulations adopted in the aftermath the global financial crisis and subsequently expanded, there is a risk of creating a model that will be extremely difficult to implement in an effective and universal manner.