Appendix A: Financial Activities in the European Union — Section 940A

Worldwide, the regulation of conglomerates is evolving. Banking, insurance, and securities regulators have recognized that the risks of the combined enterprise must be evaluated. The Joint Forum[1], a group established by the Basel Committee on Banking Supervision, the International Organization of Securities Commissions, and the International Association of Insurance Supervisors, has outlined principles related to the supervision of conglomerates.

It is widely recognized that a form of supplementary supervision is needed and that a central regulatory contact point is essential. As the word "supplementary" implies, the supervision of the enterprise is in addition to the role of the primary regulator(s) for each financial sector. Since the OTS has numerous holding companies with operations throughout the world, this guidance is designed to ensure that our regulatory approach to conglomerates is considered equivalent to the standards and principles set by other governing bodies. This approach ensures that our holding companies are on a level playing field, and not subject to unnecessary or duplicative regulatory burden by having to comply with differing regulatory schemes.

The substance of the guidance provided throughout this Section relies heavily on documents produced by the Joint Forum. In particular, in July 2001, the Joint Forum produced a compendium of documents on issues relating to conglomerates.[2] These papers document the combined thoughts of representatives of various and different financial sectors across many nations with regard to what supervisory measures are needed to adequately oversee a conglomerate. The compendium of documents address coordination among regulators, information sharing, capital adequacy, fit and proper tests on management's capabilities and effectiveness, intra-group transactions and exposures, and risk concentrations.

The European Parliament and the Council of the European Union issued a directive on December 16, 2002 (EU Directive) outlining measures to address the risks with regard to financial groups with financial activities across more than one sector.[3] The articles of the EU Directive and objectives therein outline a supervisory approach similar to that spelled out in the Joint Forum documents. U.S. companies engaged in financial activities in a member state of the European Union[4] may fall within the scope of the EU Directive.

The EU Directive defines a conglomerate as a group of companies under common control that engage predominantly in financial activities (insurance, securities, and banking). Conglomerates must have a significant interest in insurance and at least one other financial activity (banking or securities), to fall within the scope of the EU Directive. In addition, the ratio of aggregate assets of all financial sector entities to total consolidated assets of the conglomerate should exceed 40 percent.

An interest in a financial sector is considered significant if:

- The ratio of that sector's assets to the total financial sector assets exceeds 10 percent; and
- The ratio of the capital requirements imposed by the regulator of that sector to the total aggregate capital requirements for all financial sectors in the group exceeds 10 percent.

[1] The Joint Forum is comprised of an equal number of senior bank, insurance and securities supervisors representing each supervisory constituency. Thirteen countries are represented in the Joint Forum: Australia, Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Spain, Sweden, Switzerland, United Kingdom and the U.S.

[2] http://www.bis.org/publ/joint02.pdf

[3] http://europa.eu.int/eurlex/pri/en/oj/dat/2003/l_035/l_03520030211en00010027.pdf

[4] As of November 2003, the member states include Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal, Spain, Sweden, and the United Kingdom. The following countries are in process of fulfilling the requirements to accede to the European Union: Estonia, Latvia, Lithuania, Poland, Hungary, Slovakia, the Czech republic, Slovenia, Malta, and Cyprus.

The EU Directive also recognizes that it may be appropriate to apply this guidance in situations where these thresholds are not met or maintained. For instance, if one or more of the ratios noted herein fell below threshold levels during the current annual cycle, but is expected to return to prior levels. Similarly, there may be situations where these thresholds are never met, but the characteristics of the conglomerate warrant reviewing it as if it were.

The EU Directive requires that one single authority be appointed for the overview of each conglomerate and that such authority ensure that information is coordinated and exchanged between the different supervisors involved in the supervision of the conglomerate's component parts.

The regulator that will perform the supplemental supervision is typically identified through mutual agreement among all concerned member states, however, where an agreement is not reached, authority is assigned to the regulator of the parent regulated entity. If the parent is not a regulated entity, certain geographic and quantitative tests are employed to assign the role to the member state with the most significant connection to the group. Regulators in third-party countries (countries like the U.S. that are not members to the European Union) can serve in this role if their supervisory approach is deemed to be equivalent to the supplementary supervision regime. While an equivalency determination will ultimately be made by the regulatory authorities of the member states, OTS believes that its supervisory approach is equivalent. Section 940 is designed to ensure that the scope of our holding company examination of a conglomerate is sufficient to fulfill these responsibilities under the EU Directive.

If OTS is deemed equivalent, you must ensure that our responsibilities in this role are fulfilled. Our responsibilities would include gathering and disseminating relevant or essential information. We would also need to ensure that there are procedures for sharing information on an ordinary basis as well as in emergency situations. Close coordination with fellow regulators is achieved through periodic meetings, input on the content of the enterprise's supervisory plan, and sharing of information obtained in regulatory reports filed by each agency. Information sharing or regulatory cooperation agreements may be in place, but are not required by the EU Directive.

If a holding company enterprise is subject to the EU Directive, a primary staff contact will be designated to communicate with international regulatory authorities to initiate information sharing procedures and develop an appropriate Supervisory Plan for the conglomerate.