

## **JOINT FORUM ON FINANCIAL CONGLOMERATES (September 1998)**

The Joint Forum on Financial Conglomerates (Joint Forum) was established in early 1996 under the aegis of the Basle Committee on Banking Supervision (Basle Committee), the International Organisation of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS) to take forward the work of the Tripartite Group. The Tripartite Group was a predecessor informal grouping comprised of banking, securities and insurance supervisors who, beginning in 1993, examined supervisory issues arising from financial conglomerates. The executive summary of the Tripartite Group report, which was released in July 1995, was included in the previous issue of the Compendium.

The Joint Forum is comprised of an equal number of senior bank, insurance and securities supervisors representing the three parent organisations. Thirteen countries are represented: Australia, Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Spain, Sweden, Switzerland, United Kingdom and United States. The EU Commission attends in an observer capacity. Mr. Tom de Swaan initially chaired the Joint Forum but he was succeeded in November 1997 by Mr. Alan Cameron A.M., Chairman of the Australian Securities and Investments Commission.

In accordance with its mandate which was agreed by the three parent organisations, the Joint Forum has:

- reviewed various means to facilitate the exchange of information between supervisors within their own sectors and between supervisors in different sectors;
- investigated legal or other barriers which could impede the exchange of information between supervisors within their own sectors and between supervisors in different sectors;
- examined ways to enhance supervisory coordination, including the benefits and drawbacks to establishing criteria to identify and define the responsibilities of a coordinator; and
- worked on developing principles toward the more effective supervision of regulated firms within financial conglomerates.

In December 1997, the Joint Forum recommended that the parent organisations undertake a consultation procedure with the industry and the supervisory community in each of the banking, securities and insurance sectors with respect to a number of papers addressing

different aspects of supervising regulated entities within financial conglomerates. The consultative process, which is described below, was endorsed by each of the Basle Committee, IOSCO and the IAIS. The purpose of the consultation was to seek the input of industry participants and supervisors in order to advance the development of the Joint Forum's thinking and approach with respect to the oversight of financial conglomerates. The consultative process will give the Joint Forum practical insights regarding the principles and guidance elaborated to date, thereby enhancing the cooperation that already exists between supervisors, particularly intra-sector.

### ***Consultative process***

Each of the Basle Committee, IOSCO and IAIS released several consultative papers on 15<sup>th</sup> February 1998. The following Joint Forum papers were included in the consultative process for the industry and the supervisory community in each sector:

- A. *Capital Adequacy Principles* paper
- B. *Supplement to the Capital Adequacy Principles* paper
- C. *Fit and Proper Principles* paper
- D. *Framework for Supervisory Information Sharing* paper
- E. *Principles for Supervisory Information Sharing* paper
- F. *Coordinator* paper
- G. *Supervisory Questionnaire*

The *Capital Adequacy Principles* paper outlines measurement techniques and principles to facilitate the assessment of capital adequacy on a group-wide basis for financial conglomerates. The paper recognises that the solo capital adequacy requirements of each of the banking, securities and insurance sectors are different with varying definitions of the elements of capital and varying approaches to the valuations of assets and liabilities. The measurement techniques put forward are based on existing approaches used by various supervisors and are intended to complement solo requirements. The paper does not promote a single technique for universal application. The guiding principles address particular issues that should be identified in assessing the capital adequacy of financial conglomerates on a group-wide basis and are intended to assist supervisors, in the exercise of their discretion, so that the techniques will yield broadly equivalent results within a range of acceptable outcomes. The *Supplement to the Capital Adequacy Principles* paper consists of theoretical examples constructed to illustrate and describe complex situations that can arise in practical

applications of the measurement techniques. The examples are provided for general information to assist reviewers to understand the Joint Forum's thinking.

The *Fit and Proper Principles* paper, recognising that the qualifications of the top management of banks, securities firms and insurance enterprises are critical to the objectives of supervision, provides guidance intended to ensure that supervisors of entities within a financial conglomerate are able to exercise their responsibilities to assess whether those entities are soundly and prudently managed. The paper encourages the application of fitness, propriety or other qualification tests to managers and directors of other entities in a conglomerate, and to key shareholders, as defined, if they exercise a material influence on the operations of regulated entities. Further, the paper promotes arrangements to facilitate consultation and the exchange of information between supervisors with respect to managers and directors of other entities in a conglomerate who have a material influence on the operations of regulated entities.

The *Framework for Supervisory Information Sharing* paper outlines a general framework for facilitating information-sharing between supervisors of regulated entities within internationally active financial conglomerates. The framework is based on the mapping exercises carried out by a task force created by the Joint Forum to analyse the structures and operations of fourteen financial conglomerates (the Mapping Task Force) and focuses on two dimensions which tend to have particular implications for the supervision of regulated entities within financial conglomerates namely, 1) the organisation of business activities along business lines versus along the corporate legal structure and 2) the organisation of corporate control functions on a global or centralised basis versus on a local basis. The paper describes the categorisation of financial conglomerates into four "quadrants" and outlines the principal features of each quadrant and the supervisory issues arising for each quadrant.

Annexed to the *Framework for Supervisory Information Sharing* paper is the *Conglomerate Questionnaire* which was developed by the Mapping Task Force and is considered a useful tool to assist supervisors in enhancing their understanding of the structure and operations of financial conglomerates. The Questionnaire can be used by supervisors on a unilateral, bilateral or multilateral basis to facilitate discussion with representatives of a conglomerate and to assist supervisors in furthering their understanding of the conglomerate's risk profile, systems of controls and organisational/management structure. Also annexed to the paper is an outline of the types of information that would be useful to supervisors in an emergency situation.

The *Principles for Supervisory Information Sharing* paper sets out a number of guiding principles intended to assist supervisors in enhancing information sharing arrangements that will contribute to a more effective supervisory framework for financial conglomerates. The guidance recognises that the informational needs of supervisors vary considerably depending on many factors, including the objectives and approaches of supervisors themselves and the organisation and structures of individual financial conglomerates. The paper encourages supervisors to be proactive in communicating material issues and concerns with other supervisors and to build amongst themselves a climate of trust and cooperation that is essential for channels of communication to function efficiently.

The *Coordinator* paper provides guidance to supervisors for the possible identification of a coordinator or coordinators and a catalogue of possible roles and responsibilities of a coordinator or coordinators in emergency and non-emergency situations. Timely and efficient information sharing between supervisors with responsibility for different entities within a financial conglomerate may in certain circumstances be facilitated through the designation of one or more of those supervisors to play a coordination role. The paper outlines several factors that influence whether to appoint a coordinator and, if so, that impact the determination of the role and responsibilities of the coordinator. Accordingly, a catalogue of different elements of coordination is put forth to assist supervisors in designing coordination arrangements amongst themselves.

The *Supervisory Questionnaire* was developed and used by the Mapping Task Force to facilitate supervisors' understanding of each others' objectives and approaches and of their authority to share information. The continuing work of the Joint Forum and experience gained in using the Questionnaire, together with input from the consultative process, may result in changes to enhance its coverage. The Questionnaire can be used as a tool to assist supervisors in enhancing their understanding of each others' objectives and approaches.

The releases by the parent organisations were directed to the banking, securities and insurance industries and to the supervisors in each sector. The input from both the industry and the supervisory community in each sector will assist supervisors in assessing the implications of the ongoing blurring of distinctions between the activities of regulated entities in each sector and in developing approaches to ensure efficient and comprehensive oversight arrangements for financial conglomerates. The consultation process ended on 31<sup>st</sup> July 1998.

The Joint Forum is continuing work with respect to intra-group transactions and exposures within financial conglomerates. Work in this area is focusing on the application of corporate governance processes relating to and the monitoring of intra-group transactions and

exposures in conglomerates and supervisory approaches to such intra-group transactions and exposures. The Joint Forum is also pursuing work in the area of risk concentrations and large exposures.

The Joint Forum has reported on its activities for the Birmingham Summit and the G-7 Finance Ministers have extended support to its work. In particular, the G-7 Finance Ministers have endorsed the guidance that has been developed to date on coordination issues relating to the supervision of regulated financial institutions residing within financial conglomerates. The Joint Forum is proceeding with an exercise to test the principles in the Coordinator paper as an initial step in progressing the implementation of the guidance developed to date.

