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Basel Committee on Banking Supervision

Email: baselcommittee@bis.org

Dear Sirs,

**Basel Committee on Banking Supervision Consultative Document
Principles for the Supervision of Financial Conglomerates**

On behalf of the National Research University Higher School of Economics (HSE), and particularly the International Laboratory of Decision Choice and Analysis and the Laboratory of the Banking Institute we would like to thank Basel Committee on Banking Supervision for the opportunity to deliver our opinion on the Consultation Document ‘Principles for the Supervision of Financial Conglomerates’ published by the Basel Committee on Banking Supervision on December 19, 2011 at <http://www.bis.org/publ/joint27.htm>.

The comments are presented in two parts:

- a) “Principal Comments” refer to the overall issues of the financial conglomerates’ activities;
- b) “By-Paragraph Comments” deal with the particular details, i.e. point references to the consultative document are provided.

Hope our comments would be of use for deriving the principles for the effective supervision of financial conglomerates.

Yours sincerely

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Principal Comments

It is necessary to determine an approximate date when the Principles should be revised. Financial conglomerates function within the rapidly changing economic environment. Therefore it is proposed to re-examine the Principles with some regularity (for example, every two or three years). Moreover, the Document does not give any date related to the implementation of the improved Principles.

By-Paragraph Comments

§ 3, p. 5: “The Principles should be applied, on a group-wide basis, to a financial conglomerate¹⁰, defined for the purpose of this framework as any group of companies under common control or dominant influence...”

§ 4, p. 8: “Head” or “Head of the financial conglomerate (or group)” unless otherwise specified means the entity which controls or exerts dominant influence over the financial conglomerate (the head of the financial conglomerate may be the ultimate parent, or may be the head of a financial conglomerate that is a subset of the wider group).”

§ 5.III.10.1, p. 18: “The corporate governance framework should address where appropriate: the suitability of board members, senior management, key persons in control functions and significant owners, including key shareholders whose holdings are above specified thresholds or who exercise a material *influence* over the financial conglomerate’s operations”

Explicit definition and materiality criteria of *common control* or *dominant influence* are welcomed (or respective reference to IFRS or US GAAP standard) for conglomerates to be comparable.

Additional explanation is welcomed on the reasons why common control or dominant influence are to be preferred if further on it the ownership principle that is discussed (cf. point 1(b) on p. 9 of implementation criteria saying “require appropriate standards for ownership of financial conglomerates that seek to ensure financial conglomerates are not owned or controlled by unsuitable persons;”).

§ 3, p. 7: “The framework does not provide guidance regarding who should provide supervisory oversight of financial conglomerates in a given jurisdiction... This will vary among jurisdictions and financial conglomerates and is a matter for national discretion.”

It is suggested to make special document making it clear how supervision is organized given the financial conglomerate acts *in several jurisdictions* that is touched upon later in the document (cf. point 2(a) on p. 10 of implementation criteria “The legal framework should provide the authority and power to supervisors to establish and maintain close cooperation, coordination arrangements and

efficient communication with other supervisors of the financial conglomerate, including sectoral, cross sectoral, domestic and *international*.”)

§ 4, p. 8: ““Ultimate parent” means the parent of the “wider group” (ie the top parent company).”

It is proposed to revise the definition as follows accounting for the possibility of numerous parents: “Ultimate parent(s)” means the parent(s) of the “wider group” (ie the top parent company **or several top companies**).”

§5.I.5.5(a)-5(b), p. 12: “There should be a clear and agreed upon coordination process for identifying the Group-level Supervisor. The process for identifying a Group-level Supervisor should take account of the powers and authorities available to the relevant supervisors”

The Document does not clearly describe the process of identifying the Group-level Supervisor. Is it some kind of elections or assignment? In the case of assignment the Group-level Supervisor who has the power to do it? It is proposed to consider these details more carefully.

§ 5.II.6.4, p. 14: “Supervisory colleges and crisis management groups provide an effective mechanism for supervisory cooperation and coordination but *other (more frequent, less formal) mechanisms* are also important.”

It would be of high value if examples of “other (more frequent, less formal) mechanisms” were brought to the text.

§ 5.II.8.2, p. 16: “Regular contact with the board and senior management of the head of the financial conglomerate, the board and senior management of the ultimate parent...”

As there might happen that the ultimate parent (or several of them) are higher-level conglomerates (not limited to financial ones, e.g. financial-industrial conglomerates etc.) than there are envisaged problems contacting people from the ultimate parent based on the current document principles.

That is why the link between financial conglomerates on higher-level entity structures supervision is proposed to be described (probably, separate document might be of need).

§5.I.8.8(b), p. 16: “Supervisors should collect, review and analyze relevant information from the financial conglomerate and its constituent entities, including where relevant, unregulated entities”

The process of information transfer from financial conglomerates to supervisors should not come into conflict with the legislation in either country. There should be drawn a distinction between the

information which is considered as confidential information and the information that could be delivered to the supervisor.

§5.I.12.12.1, p. 21: “Managers, directors, and major shareholders (whose holdings in aggregate are above specified thresholds...)”

These thresholds are not specified in the Document. As a rule, each country has its specific thresholds. For example, in Russia there are the following types of shareholders:

- *Holdings equal more than 1% of total shares;*
- *Holdings equal more than 2% of total shares;*
- *Holdings equal more than 10% of total shares;*
- *Holdings equal more than 20% of total shares;*
- *Holdings equal more than 25% of total shares;*
- *Holdings equal more than 50% of total shares.*

It is proposed that the Principles should pay specific attention to different types of shareholders of financial conglomerates.

§5.I.15.15(c), p. 26: “Supervisors should require that the financial conglomerate's capital management policies include a requirement for the board of directors of the head of the financial conglomerate to review and approve the capital management plan at least annually, or more frequently if conditions warrant”

It is proposed that the capital management plan should be reviewed and approved at least *semi-annually* or more frequently if conditions warrant because of the rapidly changing economic environment.

Dynamic risk-factor-driven budgets and limits are to be welcomed.

§5.I.23.23.1, p. 34: “Financial conglomerates should establish risk tolerance levels which set the tone for acceptable and unacceptable risk taking”

It is proposed to give some reasonable boundaries of these risk tolerance levels. Moreover, it is recommended to explicitly list criteria for supervisors to check whether risk tolerance levels chosen by the financial conglomerates are appropriate or not.

§5.I.23.23.2, p. 34: “A financial conglomerate’s risk tolerance should be kept under periodic review so as to ensure that it remains relevant and takes account of the changing dynamics of the financial conglomerate”

It is important to note the minimal degree of regularity (for example, at least monthly, quarterly, semi-annually at most). Regular review of all the necessary information related to risk tolerance is essential in conditions of the rapidly changing economic environment.

§5.I.25.25.3, p. 35: “There will be certain functions within financial conglomerates which should not be outsourced under any circumstances”

It is proposed to make an example of these functions (e.g internal audit function, cf. Page 12, principle 15, paragraph 63 of BCBS 210 consultative paper on Internal Audit stating “It is recommended that large banks and internationally active banks perform internal audit activities using their own staff”). Otherwise, the financial conglomerates can determine the functions to be outsourced in their own way and it can run counter to the ideas of the Principles’ authors and hamper the process of supervision.

§5.I.28.28(c), p. 38: “Supervisors should require the financial conglomerate to report significant risk concentrations and intra-group transactions and exposures at the level of the financial conglomerate on a regular basis”

It is important to state the frequency of information submission (for example, semi-annually or annually). Regular reporting of all the necessary information related to risk concentrations and intra-group transactions and exposures is essential in conditions of the rapidly changing economic environment.

It is recommended to align current proposals on financial conglomerates with similar legislature (e.g. FSA consultaion paper CP12/1 on large exposure regime, cf. URL: <http://www.fsa.gov.uk/library/policy/cp/2012/12-01.shtml>).

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