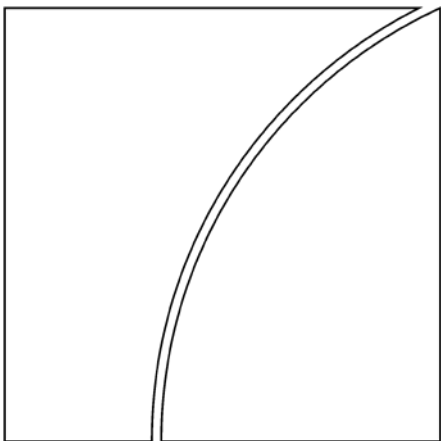


# Basel Committee on Banking Supervision

Joint Forum



## **Principles for the supervision of financial conglomerates**

September 2012



BANK FOR INTERNATIONAL SETTLEMENTS



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## THE JOINT FORUM

BASEL COMMITTEE ON BANKING SUPERVISION  
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS  
INTERNATIONAL ASSOCIATION OF INSURANCE SUPERVISORS  
C/O BANK FOR INTERNATIONAL SETTLEMENTS  
CH-4002 BASEL, SWITZERLAND

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The Joint Forum was established in 1996 under the aegis of the Basel Committee on Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS) to deal with issues common to the banking, securities and insurance sectors, including the regulation of financial conglomerates. The Joint Forum comprises an equal number of senior bank, insurance and securities supervisors representing each supervisory constituency.



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# Principles for the Supervision of Financial Conglomerates

## 1. Background

The financial crisis that began in 2007 highlighted the significant role that financial groups, including financial conglomerates, play in the stability of global and local economies. Due to their economic reach and their mix of regulated and unregulated entities (such as special purpose entities and unregulated holding companies) across sectoral boundaries, financial conglomerates present challenges for sector specific supervisory oversight. In hindsight, the crisis exposed situations in which regulatory requirements and oversight did not fully capture all the activities of financial conglomerates or fully consider the impact and cost that these activities may pose to the financial system.

The Joint Forum published various reports in February and December 1999 that together provided an initial framework for the supervision of financial conglomerates (the “1999 Principles”).<sup>1</sup> The 1999 Principles dealt with:

- techniques for assessing the capital adequacy of conglomerates, including detecting excessive gearing;
- facilitating the sharing of information among supervisors;
- coordination among supervisors;
- testing the fitness and propriety of managers, directors, and major shareholders of the conglomerate; and
- the prudent management and control of risk concentrations and intra-group transactions and exposures.

The Joint Forum recommended that the 1999 Principles be updated and expanded in a 2009 internal review and paper on the implementation of the 1999 Principles (the “Internal Review”). Also, the Joint Forum Review of the Differentiated Nature and Scope of Financial Regulation, January 2010 (the “DNSR Report”)<sup>2</sup> recommended to review and update the 1999 Principles. The DNSR Report was endorsed by the Financial Stability Board and included observations and lessons learned from the crisis as related to the activities and supervision of financial conglomerates.

The Internal Review suggested that the Principles dealing with capital adequacy, risk concentrations, and intra-group exposures needed updating to reflect industry developments and to provide greater focus on special purpose entities<sup>3</sup> and the holding companies of financial conglomerates. It also suggested that the “Fit and Proper Principles” required updating and expansion to encompass the broader areas of corporate governance.

The DNSR Report also noted a number of issues<sup>4</sup> which, if addressed, could improve supervision. The report recommended that all financial groups, particularly those active

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<sup>1</sup> The 1999 papers were grouped into a “Compendium of documents produced by the Joint Forum” (2001) at [www.bis.org/publ/joint02.htm](http://www.bis.org/publ/joint02.htm)

<sup>2</sup> Refer to [www.bis.org/publ/joint24.htm](http://www.bis.org/publ/joint24.htm)

<sup>3</sup> Refer to the Joint Forum “Report on Special Purpose Entities”, September 2009, [www.bis.org/publ/joint23.pdf](http://www.bis.org/publ/joint23.pdf)

<sup>4</sup> The report stated that the principles should be updated to (i) ensure that the principles properly address developments in sectoral frameworks and in the markets since 1999; (ii) facilitate more effective monitoring of

across borders, should be subject to regulation and supervision that captures the full spectrum of their group-wide activities and risks, including all risks from entities within the group (whether regulated or unregulated) that may have a significant impact on the financial position of the group. The report also noted that gaps in regulation and supervision should be avoided and the potential for regulatory arbitrage minimised.

The 2012 Principles for the Supervision of Financial Conglomerates (the “Principles”) in this document update and expand the 1999 Principles in line with the recommendations in the Internal Review and the DNSR Report.

The 2012 Principles take into account recent updates and developments in the principles frameworks of the Joint Forum’s Parent Committees (the BCBS, IAIS and IOSCO). They emphasise essential elements of financial conglomerate supervision: (1) the detection and correction of multiple uses of capital (ie double or multiple gearing), (2) the assessment of group risks (eg contagion, concentration, management complexity and conflicts of interest), and (3) the minimisation of regulatory arbitrage.

It should be noted that this review supports the G-20’s financial reform agenda, which includes strengthening the global financial system through more effective oversight and supervision.<sup>5</sup>

## 2. Objective

The Joint Forum’s objective in preparing these Principles is to provide national authorities, standard setters, and supervisors with a set of internationally agreed principles that support consistent and effective supervision of financial conglomerates and in particular those financial conglomerates active across borders. The Joint Forum’s aim is to focus on closing regulatory gaps, eliminating supervisory “blind spots,” and ensuring effective supervision of risks arising from unregulated financial activities and entities. The 2012 Principles should be applied in a proportionate manner to the risks posed and at least be applied to large internationally active financial conglomerates.

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activities and risks within a financial group, particularly when these activities span borders and the boundaries across the regulated and unregulated areas of the financial system; (iii) provide a basis for increased intensity of supervision and regulation of financial groups, particularly when a group or any of its institutions is identified as systemically important; (iv) improve international collaboration, coordination, and cooperation among supervisors across sectors; (v) clarify the responsibility and power of supervisors with respect to their risks in their jurisdictions stemming from an entity being part of a financial group; (vi) ensure that financial group’s structures are transparent, consistent with their business plan, and do not hinder sound risk management; and (vii) provide, to the extent possible, credible and effective options for action during a crisis or to avoid a crisis. Refer to [www.bis.org/publ/joint24.pdf](http://www.bis.org/publ/joint24.pdf).

<sup>5</sup> The communiqué from the 26-27 June 2010 G-20 Toronto summit states: “We have strengthened the global financial system by fortifying prudential oversight, improving risk management, promoting transparency, and reinforcing international cooperation. The second pillar is effective supervision. We agreed that new, stronger rules must be complemented with more effective oversight and supervision. We tasked the FSB, in consultation with the IMF, to report to our Finance Ministers and Central Bank Governors in October 2010 on recommendations to strengthen oversight and supervision, specifically relating to the mandate, capacity and resourcing of supervisors and specific powers which should be adopted to proactively identify and address risks, including early intervention.”

The 2012 Principles significantly update the 1999 Principles by providing guidance for:

- policymakers to ensure that supervisors are provided with the necessary powers, authority and resources to perform comprehensive group-wide supervision of financial conglomerates (see the *Supervisory Powers and Authority* section); and
- supervisors undertaking group-wide supervision (see the *Supervisory Responsibility* section) to ensure financial conglomerates have robust governance, capital, liquidity and risk management frameworks (see the *Corporate Governance*, *Capital Adequacy and Liquidity*, and *Risk Management* sections).

These Principles are structured in a manner that should facilitate their implementation as well as the assessment of their implementation across jurisdictions and over time.

The 2012 Principles build on the 1999 Principles in a number of ways and are organised into five sections. They are based on a revised, broader definition of a financial conglomerate. In order to cover a wide range of structures in different jurisdictions, the Principles use the flexibility of a non-prescriptive approach to the supervision of a financial conglomerate.

### **Supervisory powers and authority**

The 1999 Principles were directed to supervisors involved in the oversight of regulated financial institutions controlled by financial conglomerates and focused on supervisory information sharing and coordination (see the *Supervisory Responsibility* section).

The 2012 Principles set up new high-level principles directed to policy makers and supervisors that could be viewed as pre-conditions for effective group-wide supervision of financial conglomerates. The Principles highlight the need for a clear legal framework that provides supervisors with the necessary powers, authority and resources to perform, with independence and in coordination with other supervisors, comprehensive group-wide supervision. Comprehensive group-wide supervision should particularly include access to relevant information relating to risks posed by unregulated entities (including the head of the financial conglomerate where it is not regulated) and the ability for supervisors to take corrective supervisory actions as may be deemed necessary.

### **Supervisory responsibility**

The 1999 Principles provided supervisors involved in the oversight of regulated financial institutions controlled by financial conglomerates with a set of principles on supervisory information sharing. It also provided guidance on identifying a coordinator or coordinators and a catalogue of the elements of coordination which should be available to supervisors when considering the role and responsibilities of a coordinator or coordinators in emergency and non-emergency situations.<sup>6</sup>

The 2012 Principles reaffirm the importance of supervisory cooperation, coordination and information sharing, clarifying the importance of identifying a Group-level Supervisor whose responsibility is to focus on group-level supervision and the facilitation of coordination between relevant supervisors. The 2012 Principles set up new high-level principles which relate to the role and responsibilities of supervisors in implementing minimum prudential

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<sup>6</sup> Refer to the “Principles for Supervisory Information Sharing”, February 1999, <http://www.bis.org/publ/bcbs47c9.pdf> and <http://www.bis.org/publ/bcbs47c10.pdf>; and to the “Coordinator paper”, February 1999, <http://www.bis.org/publ/bcbs47c11.pdf>.

standards, monitoring and supervising activities of financial conglomerates and taking corrective action as appropriate.

### **Corporate governance**

The 1999 Principles were limited to fit and proper principles<sup>7</sup> and did not address broader corporate governance issues.

The 2012 Principles reaffirm the importance of fit and proper principles, through a high-level principle relating to suitability of persons involved in the management and control of financial conglomerates. They also provide, through a series of new high-level principles, guidance for supervisors intended to ensure the existence of a robust corporate governance framework for financial conglomerates. These new high-level principles relate to the structure of the financial conglomerate, the responsibilities of the board and senior management, the treatment of conflicts of interest and remuneration policy.

### **Capital adequacy and liquidity**

The 1999 Principles focused on capital assessment providing supervisors with principles and measurement techniques to facilitate the assessment of group-wide capital adequacy and to identify situations of double or multiple gearing.<sup>8</sup>

The 2012 Principles carried forward concepts from the 1999 Principles, in particular the importance of addressing the full spectrum of risks. The 2012 Principles highlight the role of the supervisors in assessing capital adequacy on a group basis, taking into account unregulated entities and activities and the risks they pose to regulated entities.

The 2012 Principles include new high-level principles relating to capital management. These new principles provide guidance for supervisors intended to ensure that financial conglomerates develop and implement robust capital management policies on a group-wide basis. The Principles provide guidance on internal capital planning processes that rely on sound board and management decisions, incorporate stressed scenario outcomes, and are subject to adequate internal controls.

The 2012 Principles also introduce a new high-level principle on liquidity assessment and management. This principle provides guidance for supervisors intended to ensure that financial conglomerates properly measure and manage liquidity risk so as to fully accommodate funding needs at all levels of the financial conglomerate in normal times and during periods of stress.

### **Risk management**

The 1999 Principles provided supervisors with principles to guide prudent management and control of risk concentrations, and intra-group transactions and exposures in financial conglomerates.<sup>9</sup>

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<sup>7</sup> Refer to the “Fit and Proper Principles paper”, February 1999, <http://www.bis.org/publ/bcbs47c4.pdf>

<sup>8</sup> Refer to the “Capital Adequacy Principles paper”, February 1999, <http://www.bis.org/publ/bcbs47ch2.pdf>

<sup>9</sup> Refer to the “Risk Concentration Principles”, December 1999, <http://www.bis.org/publ/bcbs63.pdf> and to the “Intra-group Transactions and Exposures Principles”, December 1999, <http://www.bis.org/publ/bcbs62.pdf>. See also the Joint Forum report “Cross-sectoral review of group-wide identification and management of risk concentrations”, August 2008, <http://www.bis.org/publ/joint19.pdf>.

The 2012 Principles reaffirm the importance of this guidance by setting out the need for a financial conglomerate to have a comprehensive risk management framework, including effective systems and processes to manage and report group-wide risk concentrations and intra-group transactions and exposures. They place greater emphasis on the conglomerate's ability to measure, manage and report all material risks to which the financial conglomerate is exposed, including those stemming from unregulated entities and activities.

The 2012 Principles set up new high-level principles which provide guidance for supervisors intended to ensure that financial conglomerates have in place processes and procedures to develop a sound group-wide risk management culture, to establish a risk appetite policy and define appropriate group-wide risk tolerance levels, to address risks associated with new business areas and outsourcing, to perform group-wide stress tests and scenario analyses, to prudently aggregate risks, and to bring off-balance sheet activities within the scope of group-wide supervision.

For a more detailed comparison of the 1999 Principles and the 2012 Principles, please refer to Annex 1.

### **3. Scope of application**

The Principles should be applied, on a group-wide basis, to a financial conglomerate,<sup>10</sup> defined for the purpose of this framework as any group of companies under common control or dominant influence, including any financial holding company, which conducts material financial activities in at least two of the regulated banking, securities or insurance sectors.

Jurisdictions should consider the application of the Principles to other financial groups which conduct activities in one of these regulated sectors while also conducting material activities in any other financial sector, where these financial activities are not subject to comprehensive group-wide supervision under the sectoral frameworks.

Notably, the Principles constitute a supervisory framework for financial conglomerates which is supplementary to, and does not replace, banking, insurance or securities supervisory frameworks. The Principles aim to address complexities and gaps resulting from cross-sectoral activities.

As a supplementary framework, the 2012 Principles are intended to target additional prudential risks related to the existence of a financial conglomerate and address loopholes in sectoral supervision without prejudice to sectoral supervision. The particular focus is on closing regulatory gaps, eliminating supervisory “blind spots,” and ensuring effective supervision of risks arising from unregulated financial activities and entities. The aim is effective supervision of financial conglomerates with due deference to national discretion and sectoral regulation. For example, the 2012 Principles are not intended to override or substitute for capital and liquidity regulations applicable to each sector. Supervisors should

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<sup>10</sup> For the purposes of these Principles, a group of entities with activities in only one of the regulated banking, securities, or insurance sectors, combined with commercial (ie non-financial) activities does not fall within the definition of a financial conglomerate. These groups are assumed to be covered by the supervisory framework of the relevant sector.

apply every effort to avoid creating undue burden through duplication and conflicts between the sectoral standards applied at the conglomerate level.

It is acknowledged that a degree of national discretion may be required in approaches to conglomerate supervision using these Principles, with the aim of ensuring all sources of potential risk posed by and arising within financial conglomerates are comprehensively addressed. Effective supervision may require that the supervisory powers of authorities be augmented. It is likely that, in applying the 2012 Principles, certain jurisdictions will wish to enact further legislation to advance implementation efforts. However, this need not be the case for every jurisdiction.

The 2012 Principles emphasise the importance of recognising structural complexity and the potential risks it poses, including risks arising from all entities that affect the overall risk profile and financial position of the financial conglomerate and the individual entities within the group.

### **Unregulated entities**

It is important that supervisors consider risks arising from the activities of unregulated entities, which are entities within the financial conglomerate (or the wider group to which the financial conglomerate belongs) that are not directly prudentially regulated. Each unregulated entity may present different risks to a financial conglomerate and each may require separate consideration and treatment. In deciding which unregulated entities are relevant, consideration should, at a minimum, be given to:

- operating and non-operating holding companies (including intermediate holding companies),
- unregulated parent companies and subsidiaries, and
- special purpose entities.<sup>11</sup>

At a minimum, the following characteristics, and their impact on regulated entities, should also be considered:

- (direct or indirect) participation, influence and/or other contractual obligations,
- interconnectedness,
- risk exposure,
- risk concentration,
- risk transfer,
- risk management,
- intra-group transactions and exposures,
- strategic risk, and
- reputation risk.

It is intended that these issues be considered in the widest sense, so that the lack of direct supervisory authority over a particular (unregulated) entity - within the group or within the wider group - does not preclude supervisors from reflecting in the assessment and

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<sup>11</sup> Refer to the Joint Forum “Report on Special Purpose Entities”, September 2009, [www.bis.org/publ/joint23.pdf](http://www.bis.org/publ/joint23.pdf)

supervision of the conglomerate the risks arising from such unregulated entities and their concomitant impact on the regulated entities within the conglomerate.

### Supervisory oversight

The framework does not provide guidance regarding who should provide supervisory oversight of financial conglomerates in a given jurisdiction, how supervisory powers should be derived, or which regulator, supervisor, or authority should be responsible for implementation or for monitoring compliance. This will vary among jurisdictions and financial conglomerates and is a matter for national discretion. It is important to note that the flexibility of this framework is intended to enable policymakers and supervisors, including the Group-level Supervisor, to appropriately regulate and supervise financial conglomerates, and to limit the scope for regulatory arbitrage. Therefore, the framework is purposefully not prescriptive on the roles and responsibility of the Group-level Supervisor and other supervisors, or the process for determining the Group-level Supervisor, due to the varying legal and supervision structures in different jurisdictions and also the varying nature of financial conglomerates. Additionally, the Principles build on previous guidance to coordinate supervision of complex entities.<sup>12</sup>

The most effective application of the Principles is predicated upon there being:

- a supervisor identified for each financial conglomerate (the “Group-level Supervisor”) with clearly delineated responsibility for group-level supervision and for coordination between relevant supervisors of the conglomerate;
- a clear and transparent process for ensuring effective group-level supervision, including identification of related roles and responsibilities of supervisors; and
- effective mechanisms for resolving differences between supervisors of a financial conglomerate.

## 4. Glossary

To assist in interpreting these Principles, the following functional concepts are explained:

- **“Board and senior management”** refers to the oversight function and the management function in general and should be interpreted throughout this document in accordance with the applicable law within each jurisdiction.
- **“Company(ies)”** and **“Corporate(s)”** include all types of legal entities and agreements (eg partnerships).
- **“Financial conglomerate”** is defined earlier in the section on Scope of Application.
- **“Group”** means “financial conglomerate”; **“Group-wide”** means “financial conglomerate-wide”.
- **“Group-wide supervision”** is achieved by the Group-level Supervisor and the sectoral supervisors of the financial conglomerate acting in coordination. Group-wide supervision includes supervision of the constituent entities of the financial conglomerate (and also considers interactions and relationships of these entities

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<sup>12</sup> Refer to the Joint Forum report, “Coordinator Paper”, May 1998, [www.bis.org/publ/bcbs47c11.pdf](http://www.bis.org/publ/bcbs47c11.pdf)

with entities external to the financial conglomerate but belonging to the wider group to which the financial conglomerate belongs).

- **“Group-level Supervisor”** means the supervisor responsible for group-level supervision where **“Group-level supervision”** comprises all areas of group-wide supervision not covered by sectoral supervision. It also includes coordination among the sectoral supervisors of a financial conglomerate.<sup>13</sup>
- **“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).
- **“Sectoral supervision”** means either insurance, banking or securities supervision.
- **“Sectoral supervisor”** means either an insurance, banking or securities supervisor.
- **“Significant owners”** are owners whose holdings in aggregate are above specified thresholds or who exercise a material influence because of direct or indirect participation, influence or other contractual relationship.
- **“Supervisors”** includes sectoral supervisors and other supervisors relevant to the individual, or collective, or coordinated oversight of the financial conglomerate. It generally includes the Group-level Supervisor (unless separate specific reference is made to distinguish the “Group-level Supervisor”).
- **“Ultimate parent”** means the parent of the “wider group” (ie the top parent company).
- **“Unregulated entity(ies)”** means entities that are not directly prudentially regulated by sectoral supervisors or the Group-level Supervisor.
- **“Wider group”** means the broader group to which the financial conglomerate belongs - eg in cases where the financial conglomerate is part of a larger diversified conglomerate with both financial and non-financial entities.

## 5. Principles

This chapter sets out Principles in five categories. Each Principle is followed by a set of “Implementation criteria” and “Explanatory comments”.

Implementation criteria are the steps which should be taken by authorities and supervisors to implement the Principle.

Explanatory comments are background details, descriptive in nature, which are intended to help authorities, supervisors, and assessors better understand the Principle and Implementation criteria to which they relate.

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<sup>13</sup> The concept of group-level supervision and the Group-level Supervisor builds and expands on the “Coordinator Paper” of the 1999 Principles, which indicated that it may be beneficial to designate one of the supervisors involved as the “coordinator” in order to facilitate information-sharing. In many cases, the coordinator would be the supervisor that carries out consolidated supervision or which is responsible for the largest part of the financial conglomerate. The details of the process for determining the Group-level Supervisor is likely to be jurisdiction-specific.



## I. **Supervisory powers and authority**

The objective of this section is to promote the establishment of sufficient and clear supervisory powers and authority to ensure that supervisors can conduct effective group-wide supervision of financial conglomerates, addressing all entities which may affect the overall risk profile and/or financial position of the financial conglomerate and/or the individual entities within the group. In particular, it is important that supervisors have the power to address the sources of risk to the group from any unregulated entities within the group or the wider group. It is also important that there be clear powers and authority to enable cooperation, coordination and information sharing among relevant supervisors.

### **Comprehensive group-wide supervision**

- 1. The legal framework for the supervision of financial conglomerates should grant supervisors (including the Group-level Supervisor) the necessary powers and authority to enable comprehensive group-wide supervision.**

### ***Implementation criteria***

The legal framework should grant the necessary power and authority to supervisors (including the Group-level Supervisor) to:

- 1(a) identify, or set the parameters for the identification of a financial conglomerate and the entities within the scope of supervision, particularly those entities that could pose risks to regulated entities or the broader financial system;
- 1(b) require appropriate standards for significant owners of financial conglomerates;
- 1(c) require that financial conglomerates have a sufficiently transparent group structure so as to not impede effective supervision, recovery or resolution;
- 1(d) enable, in relation to the wider group, an assessment of the risks and support provided by the wider group to the financial conglomerate;
- 1(e) access the board and senior management of the head of the financial conglomerate and of the other material and relevant entities related to the financial conglomerate, to assess the risks and support available to the financial conglomerate;
- 1(f) enable a comprehensive range of supervisory tools to be used to ensure timely corrective actions including but not limited to, actions necessary to address deficiencies in corporate governance or risk management, capital and liquidity shortfalls, large exposure concentration limits, and inappropriate group transactions;
- 1(g) deal with a crisis situation including to address concerns or issues related to resolution and recovery.

### ***Explanatory comments***

- 1.1 To assess the risk profile of the financial conglomerate the legal framework should provide clear legal authority to collect information in respect of the head and the constituent entities of the financial conglomerate including records, prudential reports and statistical returns. It should also provide the authority to collect information that is necessary to assess the level of risk and support from the wider group. Assessing support could include an assessment of risks, intra-group

transactions, risk concentrations, corporate governance and enterprise risk management.

- 1.2 The legal framework should provide sufficient enforcement powers to the supervisors to address any concerns or issues related to the financial conglomerate ranging from regulatory compliance to safety and soundness and resolution. Supervisors should have the legal authority to impose corrective action on or to limit activities of the regulated entities within the financial conglomerate, ideally including the head.
- 1.3 The legal framework should allow supervisors to adopt the measures necessary to manage and/or resolve a crisis to ensure that the financial conglomerate can be resolved safely and in an orderly manner.

#### **Cooperation and information sharing**

2. **The legal framework should grant the necessary power and authority to supervisors to enable efficient and effective cooperation, coordination and information sharing among supervisors in order to facilitate group-wide supervision.**

#### **Implementation criteria**

- 2(a) 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.
- 2(b) The legal framework should ensure that supervisors are not impeded from sharing relevant information with their domestic and foreign counterparts where there are safeguards in place to require counterparts to keep such information strictly confidential and to limit onward disclosure.

#### **Explanatory comments**

- 2.1 There will commonly be more than one supervisor responsible for entities within a financial conglomerate, particularly where the conglomerate operates across borders. Cross-border and cross-sector cooperation and information sharing is therefore critical to effective group-wide supervision. In order to efficiently supervise the financial conglomerate, an established legal framework that provides for appropriate accountability is required to enable supervisors to establish and maintain close cooperation and efficient communication and to have in place coordination arrangements with other relevant functional and/or sectoral supervisors.
- 2.2 The legal framework should provide the authority for supervisors to establish appropriate sharing of information, and to cooperate and coordinate as agreed to facilitate effective group supervision. Such cooperation or coordination may include participating in supervisory colleges, cooperating in on-site and off-site supervision and taking enforcement actions in relation to the financial conglomerate, along with sharing of information to determine the suitability of significant owners, board members, senior managers and key persons in control functions. The legal framework should not impede appropriate cooperation and information sharing and should include appropriate requirements in relation to confidentiality.

### **Independence and accountability**

- 3. The legal framework should provide supervisors with operational independence while ensuring accountability for the discharge of their duties.**

#### ***Implementation criteria***

- 3(a) The operational independence, accountability and governance structures of supervisors should be prescribed by law.
- 3(b) The responsibilities and objectives of supervisors should be clearly defined.

#### ***Explanatory comments***

- 3.1 Financial conglomerates are likely to be by nature large, influential and in the public eye. In order to effectively supervise financial conglomerates, supervisors require operational independence from inappropriate influence. Supervisors should also be subject to clear and public objectives and accountable for the discharge of their duties.
- 3.2 There should be no evidence of interference which compromises the operational independence of supervisors, or their ability to obtain and deploy the resources needed to carry out their mandates. The head of a supervisor should be removed from office during his/her term only for reasons specified in a clear, publicly disclosed, legal framework. The legal framework should ensure supervisors are protected from liability for acts taken in good faith, that the supervisors are independently governed (eg an independent board), have adequate and stable funding, and have the ability to create binding rules.

### **Resources**

- 4. Supervisors of financial conglomerates should be adequately resourced in a manner that does not undermine their independence.**

#### ***Implementation criteria***

- 4(a) Supervisors should have adequate levels of financial resources to acquire and maintain appropriate levels of human, technical, knowledge and informational resources to enable them to carry out effective and comprehensive oversight of financial conglomerates including identifying and understanding the risks borne by a financial conglomerate.
- 4(b) Supervisors should be financed in a manner which permits them to conduct effective supervision of financial conglomerates and which does not undermine their independence or their ability to carry out their duties.

#### ***Explanatory comments***

- 4.1 Given the size and complexity of financial conglomerates, effective supervision is resource intensive. Effective and comprehensive oversight of financial conglomerates requires sufficient resources for supervisors to carry out group-wide risk assessments and monitoring that may include more than one sector and may involve coordination and communication with other supervisors of the group.

- 4.2 Assessing the sufficiency of resources requires consideration of a number of factors including whether staffing numbers and skills are commensurate with the number, size and complexity of institutions supervised and whether the budget allows for sufficient resources to conduct supervision and to equip its staff with the tools needed to adequately supervise financial conglomerates.

## II. Supervisory responsibility

This section outlines ways in which supervisors with the power and authority necessary to supervise financial conglomerates can use those powers effectively.

### Group-level Supervisor

5. **Supervisors should ensure there is a clear process in place for coordinating various roles and responsibilities with clearly delineated responsibility for ensuring effective and comprehensive group-level supervision, including a coordination process to identify a group-level supervisor.**

### *Implementation criteria*

- 5 (a) There should be a clear and agreed upon coordination process for identifying the Group-level Supervisor.
- 5 (b) The process for identifying a Group-level Supervisor should take account of the powers and authorities available to the relevant supervisors.
- 5 (c) The identified coordination process should result in a single Group-level Supervisor with responsibility for effective group-level supervision and for facilitating coordination between relevant supervisors to enable effective group-wide supervision.

### *Explanatory comments*

- 5.1 In order to ensure comprehensive group-wide supervision, there should be a single Group-level Supervisor, who is responsible for effective group-level supervision of the financial conglomerate, and for facilitating coordination between sectoral and other relevant supervisors to enable effective group-wide supervision.
- 5.2 The determination of a Group-level Supervisor should take into account the powers and authorities available to the relevant supervisors and in many cases the Group-level Supervisor would likely be the supervisor that has responsibility for supervision of the head of the financial conglomerate, carries out consolidated supervision or which is responsible for the largest part of the conglomerate.
- 5.3 The determination of separate responsibilities for a Group-level Supervisor should not create the perception that other supervisors' responsibilities have shifted to the Group-level Supervisor. That is, group-level supervisory responsibility does not replace sectoral supervisory responsibility. Instead, effective group-level supervision of the financial conglomerate is required, in conjunction with and supplemental to, effective sectoral supervision, to enable effective group-wide supervision of the financial conglomerate.

- 5.4 It is important to note that the flexibility of this framework is intended to enable policymakers and supervisors to appropriately regulate and supervise financial conglomerates, including identifying the Group-level Supervisor, and to minimise the scope for regulatory arbitrage.

**Supervisory cooperation, coordination and information sharing**

- 6. Supervisors should establish a process to confirm the roles and responsibilities of each supervisor in supervising the financial conglomerate, and to ensure efficient and effective information sharing, cooperation and coordination in the supervision of the financial conglomerate.**

***Implementation criteria***

- 6(a) Supervisors should clarify the objectives, roles and responsibilities of each supervisor relevant to the financial conglomerate in order to improve the efficiency and effectiveness of the supervision.
- 6(b) Supervisors should clarify arrangements for information flows and any other form of coordination in advance where possible.
- 6(c) Supervisors should take measures to establish coordination arrangements in order to enable effective group-wide supervision, including, as appropriate, sharing information, participating in supervisory colleges, cooperating in on-site and off-site supervision and stress testing and taking enforcement actions.
- 6(d) Supervisors should establish appropriate coordination mechanisms to ensure they communicate possible cross-sectoral and cross-border exposures to each other.
- 6(e) Supervisors should develop, implement and maintain coordination arrangements for normal and stress situations.
- 6(f) Supervisors should ensure they are aware of and respect legal restrictions and onward sharing limitations, and have arrangements in place for protecting the confidentiality of information received from other supervisors.
- 6(g) Arrangements for resolving differences between supervisors should be developed, agreed to, and implemented.

***Explanatory comments***

- 6.1 The Group-level Supervisor should take the lead in ensuring supervisory cooperation, coordination and information sharing. Establishing a clear process and confirming the roles and responsibilities of each supervisor in supervising a financial conglomerate will enhance the efficiency and effectiveness of information sharing, cooperation and coordination. Clear distinction in the responsibilities of supervisors and effective coordination is also necessary to minimise supervisory gaps and overlaps.
- 6.2 The process of determining the roles and responsibilities of supervisors in relation to a financial conglomerate should take into account the structure of the financial conglomerate; the characteristics of the regulated entities (eg size, sector) and other entities which form part of the financial conglomerate; the presence and dominance of sectors within the financial conglomerate; the location of entities and the location

of the markets in which the entities operate; and the powers, authority, resources available to, and location of, each relevant supervisor. There should be coordination of the regulations and supervision applying to financial conglomerates on a cross border and cross sector basis.

- 6.3 It is important that supervisors have well-established mechanisms of supervisory cooperation, coordination and sufficient, relevant, timely and reliable information sharing at cross-sector and cross-jurisdiction levels for both normal and stress situations. Arrangements for stress situations are likely to differ from those for normal situations for reasons of speed or importance. Supervisors should take appropriate steps to maintain confidentiality of information that is shared in relation to financial conglomerates under the information sharing, cooperation and coordination framework.
- 6.4 Supervisors should promote proactive communication and responses to material risk aggregations (particularly cross-sectoral), emerging issues and concerns in a timely manner. Well established and regular communication should alleviate issues such as the potential for differing views across supervisors as to what constitutes a material event or piece of information and for information to be understood in context. Well-established and regular communication should also enable each supervisor to discharge its duties to effectively supervise the financial conglomerate or the regulated entities within the financial conglomerate for which they have responsibility. 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.
- 6.5 Supervisors should communicate possible cross sectoral and cross border risk concentrations to each other to ensure that the conglomerate has considered such risks. For example, a geographical concentration could occur where a bank originates and holds mortgages in the same area that a sister insurer insures houses, or securities firms manage or own real estate. A catastrophic event such as a hurricane or earthquake might create cross-sectoral and interacting effects within a conglomerate. It is important that supervisors are attuned to such possible effects so as to be able to subsequently challenge management on whether such effects are being considered.
- 6.6 Regular reviews of arrangements for the sharing of information, and supervisory coordination, are necessary to ensure arrangements work in practice and are enhanced where possible.
- 6.7 Supervisors of different parts of a financial conglomerate should agree to a process for resolving differences between themselves under both normal and stress scenarios for the financial conglomerate. These differences may arise, for example, in relation to the undertaking of specific supervisory actions in relation to entities within the conglomerate or in the identification of the Group-level Supervisor. It is important that there are mechanisms to resolve such differences so that group-wide supervision of the financial conglomerate and the sectoral supervision of entities within the conglomerate are not unduly impeded.

## **Prudential standards and coverage**

- 7. Supervisors should establish, implement and maintain a comprehensive framework of risk-based minimum prudential standards for financial conglomerates.**

### ***Implementation criteria***

- 7(a) Supervisors should establish and maintain a comprehensive framework of minimum risk-based prudential standards that is updated as necessary to remain effective.
- 7(b) Supervisors should ensure that prudential standards adequately address risks that are heightened for financial conglomerates, including double gearing, contagion risk, concentration risk, conflicts of interest and intra-group exposures.
- 7(c) Supervisors should ensure standards are clear in their application to various entities of the financial conglomerate.
- 7(d) Supervisors should require adequate public disclosure by the financial conglomerate in relation to its financial condition, governance and risk management in a manner that is easily accessible.

### ***Explanatory comments***

- 7.1 Financial conglomerates require a clear framework of minimum prudential standards within which to operate. Such a framework sets clear expectations for the financial conglomerate and should facilitate the strengthening of its practices in key areas.
- 7.2 Effective supervision of financial conglomerates also requires a strong framework of minimum prudential standards against which supervisors are able to appropriately assess the financial conglomerates.
- 7.3 The fundamental components of a prudential framework include requirements in relation to governance, capital adequacy and liquidity, and risk management, and these components are equally relevant for financial conglomerates. Risks that are heightened for financial conglomerates include (but are not limited to) double gearing, contagion risk, concentration risk, conflicts of interest and intra-group transactions and exposures. These risks need to be adequately addressed in the prudential framework for financial conglomerates.
- 7.4 To facilitate compliance by, and supervision of, financial conglomerates, the supervisory framework should be clear as to which elements apply to the head of the financial conglomerate and which apply to other entities within the conglomerate. The framework and standards should supplement existing core principles and prudential requirements of sectoral supervisors that are applied in respect of entities within the financial conglomerate.
- 7.5 Transparency through adequate disclosure of information in relation to the financial condition, governance and risk management of a financial conglomerate is important to support market discipline. Such disclosure should be made in a manner that is easily accessible and comprehensive and may include information in relation to the financial conglomerate's consolidated financial condition and performance, risk exposures, risk management strategies and corporate governance policies and processes.

- 7.6 As industry and markets evolve and develop over time, it is important that regulatory and supervisory approaches also evolve. Hence the prudential framework needs to be regularly reviewed to ensure that it remains effective and relevant. This review is particularly important in the context of financial conglomerates given their potential diversity and complexity and the likelihood that they will be operating across a number of jurisdictions and evolving over time.

#### **Monitoring and supervision**

- 8. Supervisors should develop and maintain a sound understanding of the operations of financial conglomerates through undertaking a range of appropriate supervisory activities.**

#### **Implementation criteria**

- 8(a) Supervisors, and in particular the Group-level Supervisor, should form an assessment of the risks of the financial conglomerate on an integrated basis, including making a forward-looking assessment of the sources of risk to the financial conglomerate.
- 8(b) Supervisors should collect, review and analyse relevant information from the financial conglomerate and its constituent entities, including where relevant, unregulated entities.
- 8(c) Supervisors should review the consistency of the financial conglomerate's own assessment of its risks at the sector levels as well as on an aggregated basis.
- 8(d) Supervisors should have sufficient interaction with the board and senior management of the head of the financial conglomerate, the board and senior management of the ultimate parent, and of material and relevant entities within the financial conglomerate.
- 8(e) Supervisors should undertake on-site and off-site supervision of financial conglomerates and assess compliance with the prudential framework.

#### **Explanatory comments**

- 8.1 Supervisors should form a comprehensive view of the overall operations, group business strategy, financial position, legal and regulatory position, governance arrangements and the risk exposure of the financial conglomerate, and establish compliance with the prudential framework. Supervisors should also consider the broader risks to which the financial conglomerate is exposed from the environment in which it operates.
- 8.2 To form this understanding, supervisors need to access sufficient and timely information (and need to compel further information and greater timeliness when warranted) and conduct on-site and off-site assessments. On-site work is important for broadening and deepening supervisory understanding of the financial conglomerate, verifying the reliability of information provided and for assessing the effectiveness of internal control systems. Regular contact with the board and senior management of the head of the financial conglomerate, the board and senior management of the ultimate parent, and of material and relevant entities within the financial conglomerate ensures access to those who play a key role in driving the direction and protecting the soundness of the financial conglomerate. Regular



communication with key persons within the financial conglomerate such as risk management staff and internal audit is also important.

- 8.3 A forward-looking assessment of the sources of risk to the financial conglomerate, including consideration of contagion risks, is important to enable risks to be identified and addressed as they emerge.

#### **Supervisory tools and enforcement**

- 9. Supervisors should, when appropriate, utilise supervisory tools to compel timely corrective actions and/or enforce compliance of financial conglomerates with the prudential framework.**

#### ***Implementation criteria***

- 9(a) Supervisors should, when appropriate, impose sanctions on or require corrective actions to be taken by the financial conglomerate or its constituent entities, subject to appropriate due process. Sanctions and corrective actions may be qualitative or quantitative.

#### ***Explanatory comments***

- 9.1 Having a legal framework of rules and standards that provides the capacity and sufficient authority for supervisors to require a range of timely corrective actions in response to both on-going and emergent situations is insufficient to ensure effective group-wide supervision. Supervisors should be able to demonstrate both an ability and willingness to take timely action when appropriate.
- 9.2 Sanctions or corrective actions should be used to address sources of risk or issues of non-compliance and may include, but are not limited to, restricting current or future activities, suspending dividends to shareholders of relevant entities within the financial conglomerate and other measures to prevent capital from falling below the required levels. The exercise of sanctions or imposition of corrective actions should be subject to appropriate due process, including mechanisms for appeal where necessary.

### **III. Corporate Governance**

Broadly, corporate governance describes the processes, policies and laws that govern how a company or group is directed, administered or controlled. It defines the set of relationships between a company's management, its board, its shareholders, and other recognised stakeholders.<sup>14</sup> Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

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<sup>14</sup> The legal and regulatory system in a country determines the formal responsibilities institutions have to shareholders and other relevant stakeholders. This document will use the phrase "recognised stakeholders" to reflect the fact that responsibilities in this regard vary across jurisdictions and sectors.

Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring. The presence of an effective corporate governance system, within an individual company or group and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy.

Financial conglomerates are often complex groups with multiple regulated and unregulated financial and other entities. Given this inherent complexity, corporate governance must carefully consider and balance the combination of interests of recognised stakeholders of the ultimate parent, and the regulated financial and other entities of the group. Ensuring that a common strategy supports the desired balance and that regulated entities are compliant with regulation on an individual and on an aggregate basis should be a goal of the governance system. This governance system is the fiduciary responsibility of the board of directors.

When assessing corporate governance across a financial conglomerate, supervisors should apply these principles in a manner that is appropriate to the relevant sectors and the supervisory objectives of those sectors.

This section describes the elements of the governance system most relevant to financial conglomerates, and how they should be assessed by supervisors.

#### **Corporate governance in financial conglomerates**

- 10. Supervisors should seek to ensure that the financial conglomerate establishes a comprehensive and consistent governance framework across the group that addresses the sound governance of the financial conglomerate, including unregulated entities, without prejudice to the governance of individual entities in the group.**

#### **Implementation criteria**

- 10(a) Supervisors should require that the corporate governance framework of the financial conglomerate has minimum requirements for good governance of the entities of the financial conglomerate which allow for the prudential and legal obligations of its constituent entities to be effectively met. The ultimate responsibility for the sound and prudent management of a financial conglomerate rests with the board of the head of the financial conglomerate.
- 10(b) Supervisors should require that the financial conglomerate emphasises a high degree of integrity in the conduct of its affairs.
- 10(c) Supervisors should seek to ensure that the corporate governance framework appropriately balances the diverging interests of constituent entities and the financial conglomerate as a whole.
- 10(d) Supervisors should require that the governance framework respects the interests of policy holders and depositors (where relevant), and should seek to ensure that it respects the interests of other recognised stakeholders of the financial conglomerate and the financial soundness of entities in the financial conglomerate.
- 10(e) Supervisors should require that the governance framework includes adequate policies and processes that enable potential intra-group conflicts of interest to be avoided, and actual conflicts of interest to be identified and managed.

### ***Explanatory comments***

- 10.1 The corporate governance framework should address where appropriate:
- alignment to the structure of the financial conglomerate;
  - financial soundness of the significant owners;
  - suitability of board members, senior management and key persons in control functions including their ability to make reasonable and impartial business judgments;
  - fiduciary responsibilities of the boards of directors and senior management of the head company and material subsidiaries;
  - management of conflicts of interest, in particular at the intra-group level and remuneration policies and practices within the financial conglomerate; and
  - internal control and risk management systems and internal audit and compliance functions for the financial conglomerate.
- 10.2 The group's corporate governance framework should notably include a strong risk management framework (refer to the Risk Management section), a robust internal control system, effective internal audit and compliance functions, and ensure that the group conducts its affairs with appropriate independence and a high degree of integrity.
- 10.3 Group-wide governance not only involves the governance of the head of the financial conglomerate, but also applies group-wide to all material activities and entities of the financial conglomerate.
- 10.4 In the event the local corporate governance requirements applicable to any particular material entity in the financial conglomerate are below the group standards, the more stringent group corporate governance standards should apply, except where this would lead to a violation of local law.
- 10.5 Supervisors should require that the corporate governance framework of the financial conglomerate includes a code of ethical conduct.
- 10.6 Supervisors should require that the financial conglomerate have in place policies focused on identifying and managing potential intra-group conflicts of interest, including those that may result from intra-group transactions, charges, up streaming dividends, and risk-shifting. The policies should be approved by the board of the head of the financial conglomerate and be effectively implemented throughout the group. The policies should recognise the long-term interest of the financial conglomerate as a whole, the long term interest of the significant entities of the financial conglomerate, the stakeholders within the financial conglomerate, and all applicable laws and regulations.

## **Structure of the financial conglomerate**

- 11. Supervisors should seek to ensure that the financial conglomerate has a transparent organisational and managerial structure, which is consistent with its overall strategy and risk profile and is well understood by the board and senior management of the head company.**

### ***Implementation criteria***

- 11(a) Supervisors should understand the financial conglomerate's group structure and the impact of any proposed changes to this structure.
- 11(b) Supervisors should assess the ownership structure of the financial conglomerate, including the financial soundness and integrity of its significant owners.
- 11(c) Supervisors should seek to ensure that the structure of the financial conglomerate does not impede effective supervision. Supervisors may seek restructuring under appropriate circumstances to achieve this, if necessary.
- 11(d) Supervisors should seek to ensure that the board and senior management of the head of the financial conglomerate are capable of describing and understanding the purpose, structure, strategy, material operations, and material risks of the financial conglomerate, including those of unregulated entities that are part of the financial conglomerate structure.
- 11(e) Supervisors should assess and monitor the financial conglomerate's process for approving and controlling structural changes, including the creation of new legal entities.
- 11(f) Where the financial conglomerate is part of a wider group, supervisors should require that the board and senior management of the head of the financial conglomerate have governance arrangements that enable material risks stemming from the wider group structure to be identified and appropriately assessed by relevant supervisory authorities.
- 11(g) Supervisors should seek to ensure that there is a framework governing information flows within the financial conglomerate and between the financial conglomerate and entities of the wider group (eg reporting procedures).

### ***Explanatory comments***

- 11.1 A financial conglomerate may freely set its functional, hierarchical, business and/or regional organisation, provided all entities within the financial conglomerate comply with their relevant sectoral and legal frameworks.
- 11.2 Elements to be considered for assessing the significant ownership structure of the financial conglomerate may include the identification of significant owners, including the ultimate beneficial owners, the transparency of their ownership structure, their financial information, and the sources of their initial capital and all other requirements of national authorities. At a minimum, the necessary qualities of significant owners relate to the integrity demonstrated in personal behaviour and business conduct, as well as to the ability to provide additional support when needed.

- 11.3 Supervisors should seek to ensure that a financial conglomerate has an organisational and managerial structure that promotes and enables prudent management, and if necessary, orderly resolution aligned with corresponding sectoral requirements. Reporting lines within the financial conglomerate should be clear and should facilitate information flows within the financial conglomerate, both bottom-up and top-down.
- 11.4 Supervisors should be satisfied that the board and senior management of the head of the financial conglomerate understand and influence the evolution of an appropriate group legal structure in alignment with the approved business strategy and risk profile of the financial conglomerate, and understand how the various elements of the structure relate to one another. Where a financial conglomerate creates many legal entities, their number and, particularly, the interconnections and transactions between them, may pose challenges for the design of effective corporate governance arrangements. This risk should be recognised and managed. This is particularly the case where the organisational and managerial structure of the financial conglomerate deviates from the legal entity structure of the financial conglomerate.
- 11.5 Supervisors should assess changes to the group structure and how these changes impact its soundness, especially where such changes cause the financial conglomerate to engage in activities and/or operate in jurisdictions that impede transparency or do not meet international standards stemming from sectoral regulation.

**Suitability of board members, senior managers and key persons in control functions**

- 12. Supervisors should seek to ensure that the board members, senior managers and key persons in control functions in the various entities in a financial conglomerate possess integrity, competence, experience and qualifications to fulfil their role and exercise sound objective judgment.**

***Implementation criteria***

- 12(a) Supervisors should be satisfied of the suitability of board members, senior managers and key persons in control functions.
- 12(b) Supervisors should require financial conglomerates to have satisfactory processes for periodically assessing suitability.
- 12(c) Supervisors should require that the members of the boards of the head of the financial conglomerate and of its significant subsidiaries act independently of parties and interests external to the wider group; and that the board of the head of the financial conglomerate include a number of members acting independently of the wider group (including owners, board members, executives, and staff of the wider group).
- 12(d) Supervisors should communicate with the supervisors of other regulated entities within the conglomerate when board members, senior management and key persons in control functions are deemed not to meet their suitability tests.

***Explanatory comments***

- 12.1 Board members, senior managers and key persons in control functions need to have appropriate skills, experience and knowledge, and act with care, honesty and

integrity, in order to make reasonable and impartial business judgments and strengthen the protection afforded to recognised stakeholders. To this end, institutions need to prudently manage the risk that persons in positions of responsibility may not be suitable. Suitability criteria may vary depending on the degree of influence on or the responsibilities for the financial conglomerate.

- 12.2 Supervisors of regulated entities of the financial conglomerate are subject to statutory and other requirements in applying suitability tests to these entities in their jurisdiction. The organisational and managerial structure of financial conglomerates adds elements of complexity for supervisors seeking to ensure the suitability of persons. For instance, the management of regulated entities within the financial conglomerate can be extensively influenced by persons who are not directly responsible for such functions. A group-wide perspective regarding suitability of persons is intended to close any loopholes in this respect. Supervisors may rely on assessments made by other relevant supervisors in this area regarding suitability. Alternatively they may decide on concerted supervisory actions regarding suitability if required.
- 12.3 In order to meet suitability requirements, board members, senior managers and key persons in control functions, both individually and collectively, should have and demonstrate the ability to perform the duties or to carry out the responsibilities required in their position. Competence can generally be judged from the level of professionalism (eg pertinent experience within financial industries or other businesses) and/or formal qualifications.
- 12.4 Serving as a board member or senior manager of a company (from the wider group) that competes or does business with the regulated entities in the financial conglomerate can compromise independent judgment and create conflicts of interest, as can cross-membership on boards. A board's ability to exercise objective judgment independent of the views of executives and of inappropriate political or personal interests can be enhanced by recruiting members from a sufficiently broad population of candidates. The key characteristic of independence is the ability to exercise objective, independent judgment after fair consideration of all relevant information and views without undue influence from executives or from inappropriate external parties and interests and while taking into account the requirements of applicable law.

#### **Responsibility of the board of the head of the financial conglomerate**

- 13. Supervisors should require that the board of the head of the financial conglomerate appropriately defines the strategy and risk appetite of the financial conglomerate, and ensures this strategy is implemented and executed in the various entities, both regulated and unregulated.**

#### **Implementation criteria**

- 13(a) Supervisors should require that the board of the head of the financial conglomerate has in place a framework for monitoring compliance with the strategy and risk appetite across the financial conglomerate.
- 13(b) Supervisors should require that the board of the head of the financial conglomerate regularly assesses the strategy and risk appetite of the financial conglomerate to ensure it remains appropriate as the conglomerate evolved.

- 13(c) Where the financial conglomerate is part of a wider group, supervisors should assess whether the head is managing its relationship with the wider group and ultimate parent in a manner that is consistent with the governance framework of the financial conglomerate.
- 13(d) Supervisors should require that a framework is in place which seeks to ensure resources are available across the financial conglomerate for constituent entities to meet both the group and their own entity's governance standards.

***Explanatory comments***

- 13.1 Supervisors should assess if the board of directors exercises adequate oversight over the management of the head of the financial conglomerate. This includes assessing the actions taken by the board of the head to define the strategy for the financial conglomerate and ensure the consistency of the operations of the various entities in the financial conglomerate with such strategy. To this end, the head company should set up an adequate corporate governance framework in line with the structure, business and risks of the financial conglomerate and its entities and applicable laws. This framework should ensure that the strategy is implemented and monitored throughout the financial conglomerate and reviewed on a regular basis and following material change including due to growth, increased complexity, geographic expansion, etc.
- 13.2 The head company should exercise adequate oversight of subsidiaries, both regulated and unregulated, while respecting independent legal and governance responsibilities. Supervisors should satisfy themselves that entities within a financial conglomerate adhere to the same group-wide corporate governance principles or at least apply policies that remain consistent with these principles. The board of a regulated subsidiary of a financial conglomerate will retain and set its own corporate governance responsibilities and practices in line with its own legal requirements or in proportion to its size or business. These should not, however, conflict with the broader financial conglomerate corporate governance framework. Appropriate governance arrangements will address arrangements such that legal or regulatory provisions or prudential rules of regulated subsidiaries will be known and taken into account by the head company.
- 13.3 Where the financial conglomerate is part of a wider group structure, the head of the financial conglomerate is responsible for managing the relationship with its wider group. This includes ensuring there are appropriate arrangements for capital and liquidity management, assessing any material risk impact that may come from decisions made at its ownership level, service level agreements, reporting lines and regular top-level consultations with related companies in the wider group and the ultimate parent.
- 13.4 For smaller institutions within a larger conglomerate, it may be unnecessary to duplicate systems and controls. Such smaller institutions can rely on the systems and controls of the head if they have assessed that this is suitable to address group risks.
- 13.5 Supervisors should be satisfied with the amount and quality of information they receive from the head company of the financial conglomerate on its strategy, risk appetite and corporate governance framework.

### **Remuneration in a financial conglomerate**

- 14. Supervisors should require that the financial conglomerate has and implements an appropriate remuneration policy that is consistent with its risk profile. The policy should take into account the material risks that organisation is exposed to, including those from its employees' activities.**

#### ***Implementation criteria***

- 14(a) Supervisors should require that an appropriate remuneration policy consistent with established international standards is in place and observed at all levels and across jurisdictions in the financial conglomerate. An appropriate policy aligns risk-takers' variable remuneration with prudent risk taking, promotes sound and effective risk management, and takes into account any other appropriate factors. The overarching objective of the policy should be consistent across the group but can allow for reasonable differences based on the nature of the constituent entities/units and local legal requirements.
- 14 (b) Supervisors should require that ultimate oversight of the remuneration policy rest with the financial conglomerate's head company.
- 14(c) Supervisors should require that the remuneration of board members, senior managers and key persons in control functions be determined in a manner that does not incentivise them to disregard the obligations they owe to the financial conglomerate or any of its entities, nor to otherwise act in a manner contrary to any legal or regulatory obligations.
- 14(d) Supervisors should require that the risks associated with remuneration are reflected in the financial conglomerate's broader risk management framework. For example, staff engaged in financial and risk control at the group-wide level should be compensated in a manner that is consistent with their control role and should be involved in designing incentive arrangements, and assessing whether such arrangements encourage imprudent risk-taking.
- 14(e) Supervisors should require that the variable remuneration received by risk management and control personnel is not based substantially on the financial performance of the business units that they review but rather on the achievement of the objectives of their functions (eg adherence to internal controls).

#### ***Explanatory comments***

- 14.1 Remuneration is a key aspect of any governance framework and needs to be properly considered in order to mitigate the risks that may arise from poorly designed remuneration arrangements. The risks associated with remuneration should be reflected in the financial conglomerate's broader risk management framework.
- 14.2 Remuneration may serve important objectives, including attracting skilled staff, promoting better organisation-wide and employee performance, promoting retention, providing retirement security and allowing personnel costs to vary with revenues. It is also clear, however, that ill-designed compensation arrangements can provide incentives to take risks that are not consistent with the long term health of the organisation. Such risks and misaligned incentives are of particular supervisory interest.



- 14.3 Ultimately a financial conglomerate's remuneration policy should aim to ensure effective governance of remuneration, alignment of remuneration with prudent risk-taking, and engagement of recognised stakeholders.
- 14.4 Supervisors should ensure that the governance system identifies and closes loopholes that allow the circumvention of conglomerate, sectoral or entity-level remuneration requirements.
- 14.5 Board members, senior managers and key persons in control functions should be measured against performance criteria tied not only to the short-term, but also to the long-term interest of the financial conglomerate as a whole.

## **IV. Capital adequacy and liquidity**

The principles for capital adequacy described here are intended to supplement principles for sectoral supervision. As noted in the opening section, the 2012 Principles are therefore not intended to override or substitute for capital and liquidity regulations applicable to each sector. A supplementary assessment of capital adequacy is necessary only if the relevant sectoral framework does not fully address the nature and scope of the financial conglomerate for the purpose of ensuring capital adequacy on a group-wide basis. Supervisors should seek to prevent regulatory arbitrage of capital and liquidity requirements within groups spanning multiple sectors.

### **Capital management**

Supervisors should require that the financial conglomerates' capital management policies, and the processes used to devise and implement these policies, are prudent, robust and take into account additional risks associated with unregulated activities and additional complexities related to cross-sectoral activities.

#### **15. Supervisors should require that the financial conglomerate:**

- 15(i) maintains adequate capital on a group-wide basis to act as a buffer against the risks associated with the group's activities;**
- 15(ii) develops capital management policies that are approved and regularly reviewed by the board, and that include a clearly and formally documented capital planning process that ensures compliance with capital requirements on a group-wide and regulated entity basis; and**
- 15(iii) considers and assesses the group-wide risk profile when undertaking capital management.**

### **Implementation criteria**

- 15(a) Supervisors should require that the financial conglomerate proactively manage its capital through a rigorous, board-approved, comprehensive and well documented process to ensure it maintains adequate capital within the group and its constituent entities.
- 15(b) Supervisors should require that financial conglomerate's capital management policies include a process to arrive at board and management decisions regarding capital management (including dividend distributions, capital instrument issuances,

redemptions and repurchases) and that such decisions reflect robust capital planning and incorporate stress scenario outcomes.

- 15(c) Supervisors should require that the financial conglomerate's capital management policies include a requirement for the board of directors or the head of the financial conglomerate to review and approve the capital management plan at least annually, or more frequently if conditions warrant.
- 15(d) Supervisors should require that there exist an independent review process, eg involving an internal audit unit within the financial conglomerate, to ensure the integrity of the overall capital management process of the financial conglomerate, taking into consideration requirements at individual entities within the financial conglomerate.
- 15(e) Supervisors should require that the capital planning process include capital adequacy goals with respect to degree and type of risk exposure, taking account of the conglomerate's strategic focus and business plan.
- 15(f) Supervisors should require that the capital planning process take into consideration the group-wide risk profile and appetite, and the possible negative impacts to its capital position from the material entities and relevant business risks to which it is exposed.
- 15(g) Supervisors should require that the capital planning process identify and measure all material risks potentially requiring capital. Both on- and off-balance sheet risks as well as the activities and exposures of any unregulated entities within the group should be considered. Risks should be considered not only in isolation but also in aggregate.
- 15(h) Supervisors should require that the capital planning process determine quantifiable internal capital targets, along with practicable plans for achieving and maintaining these targets under both normal and stressed conditions. This should include processes to alert management of potential breaches.
- 15(i) Supervisors should require that the capital planning process identify the actions that management is expected to take when its capital position falls below, or is anticipated to fall below, its internal capital target.
- 15(j) Supervisors should require that the capital planning process take into consideration the availability of capital across entities within the group. This should include the regulatory, legal and other impediments to the transfer of capital across entities, sectors and jurisdictions in which the financial conglomerate operates.
- 15(k) Supervisors should require that intra-group guarantees, potential future injections of capital, and future management actions not be taken into account in the setting of an internal capital target.
- 15(l) Supervisors should require that the capital planning process take into consideration the current and forecast business and macroeconomic environment. It should incorporate forward-looking stress testing that identifies possible events or changes in market conditions that could adversely impact the group's capital position.

### **Capital assessment**

Supervisors should assess the capital adequacy of financial conglomerates on a group-wide basis, with attention to the level of the underlying resources for loss absorption, the quality of

those resources, and the degree to which resources are available to support the operations of entities within the group.

- 16. Supervisors should require that the capital adequacy assessments undertaken by the financial conglomerate consider group-wide risks, including those undertaken by unregulated entities within a financial conglomerate, and that these assessments soundly address third party participations and minority interests.**

***Implementation criteria***

- 16(a) Supervisors should require that all entities, whether regulated or unregulated, are included in the capital assessment of the group. Unregulated entities should be brought into the group-wide assessment via capital proxy or through deduction.
- 16(b) Supervisors should, where appropriate and taking into account sectoral requirements, impose specific additional capital requirements, including for material risk exposures and investments in particular entities, when calculating capital requirements.
- 16(c) Where risk has been transferred from regulated to unregulated entities in a group, supervisors of the regulated entities should look through to the overall quantum and quality of assets in the unregulated entity.

***Explanatory comments***

- 16.1 In undertaking its risk assessment, the financial conglomerate and its regulated entities should assess risks across the group. The risks should include those undertaken across the financial conglomerate, including by unregulated entities such as special purpose vehicles and other off-balance sheet entities, holding and intermediate holding companies.
- 16.2 Supervisors should have the power to impose specific capital requirements on the financial conglomerate for material risks in constituent entities when calculating group-wide capital requirements, particularly in situations where their assessment is that the total requirement for the conglomerate ought to be higher than the sum of that for individual component businesses. Such situations would include, for example, complexity of the group structure, which could lead to contagion risk across entities.

- 17. Supervisors should require that capital adequacy assessment and measurement techniques consider double or multiple gearing.**

***Implementation criteria***

- 17(a) Supervisors should require that situations of double or multiple use of capital (eg when a holding company provides regulatory capital to another group entity) are adequately addressed in the capital assessment of the group.
- 17(b) Supervisors should require participations that confer effective control to be consolidated in full.

- 17(c) Supervisors should require that the capital adequacy assessments of the group and its components, as appropriate, exclude intra-group holdings of regulatory capital if not performed on a fully consolidated basis.
- 17(d) Supervisors should be alert to ownership structures that pose prudential concerns (eg sister entities owning capital), and overly complex organisational structures that could obscure instances of double or multiple gearing within the financial conglomerate.
- 17(e) Supervisors should be aware that problems, similar to those posed by intra-group double or multiple gearing, can also occur when different conglomerates hold cross participations in each other or in each other's dependants.

### ***Explanatory comments***

- 17.1 Double or multiple gearing occurs within groups that are not fully consolidated at every level and when one entity holds regulatory capital issued by another entity within the same group and the issuer is permitted to include the capital in its own balance sheet.
- 17.2 In general, where a group is subject to capital requirements on a fully consolidated basis and the subsidiaries are also subject to consolidated capital requirements, the conglomerate derives no regulatory capital benefit from double gearing and, accordingly, supervisory concerns are mitigated. The issue of double or multiple gearing of capital arises where the same capital is used simultaneously as a buffer against risk in two or more legal entities, including situations where this is done via unregulated intermediate holding companies that have participations in dependants or affiliates engaged in financial activities.

**18. Supervisors should require that capital adequacy assessment and measurement techniques address excessive leverage and situations where a parent issues debt and down-streams the proceeds in the form of equity to a subsidiary.**

### ***Implementation criteria***

- 18(a) Supervisors should require that the assessment of capital adequacy of a financial conglomerate incorporate the effect of the capital structure.
- 18(b) Supervisors should assess the methods by which the down-streaming of proceeds from parents to subsidiaries occurs, and their potential to produce undetected excessive leverage.
- 18(c) Capital adequacy measurement techniques should consider the potential for undue pressure to service a parent's debt (eg the obligation of a regulated subsidiary to pay dividends to its parent).

### ***Explanatory comments***

- 18.1 Excessive leverage can occur when a parent issues debt (or other instruments not acceptable as regulatory capital in the downstream entity) and down-streams or

passes the proceeds to a dependant in the form of equity or other elements of regulatory capital. In this situation, the effective leverage of the dependant<sup>15</sup> may be greater than its leverage calculated on a solo basis. While this type of leverage is not necessarily unsafe or unsound, excessive use can constitute a prudential risk. For example, if undue pressure is placed on the regulated entity to pay dividends to the parent company so the latter can service its debt. A similar problem can arise where a parent issues capital instruments of one quality and down-streams them as instruments of a higher quality.

- 18.2 While such asymmetrical down-streaming poses significant prudential concerns where the group is not subject to consolidated capital requirements, it can give rise to excessive leverage at the subsidiary level even in groups subject to a consolidated capital requirement, and thus should be subject to significant supervisory monitoring.
- 18.3 In the particular case of the head of a financial conglomerate, assessment of group-wide capital adequacy by supervisors will need to encompass the effect on the group of the capital structure. To achieve this, supervisors will need to be able to obtain information about the head company, so as to make an assessment of its ability to service all external debt.

**19. Supervisors should require that assessment and measurement techniques evaluate any limitations on intra-group transfers of capital, taking into account potential impediments to executing such transfers that could constrain their suitability for inclusion in the assessment of group capital.**

#### **Implementation criteria**

- 19(a) In their group-wide assessment of participations, supervisors should determine whether there are existing or potential impediments to the effective transfer of capital within the group.
- 19(b) Supervisors should require that funds treated as available and included in the group-wide capital assessment are legitimately movable within the group should the need arise.
- 19(c) Supervisors should require that the regulatory capital in a dependant and the corresponding capital requirements are calculated according to the rules applicable to the financial sector and jurisdiction in question, except where the supervisor of the head company deems it necessary to use an alternative measure or proxy.
- 19(d) Before recognising any excess capital in a dependant on the balance sheet of the head of the financial conglomerate, supervisors should ensure that the excess capital comprises adequate capital elements.

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<sup>15</sup> Where an entity exerts control or dominant influence over a second entity, this second entity is a “dependant” of the first entity.

- 19(e) Supervisors should assess the appropriateness of the distribution of capital resources within the group independent of the group's ability to transfer capital across entities within the group.

***Explanatory comments***

- 19.1 A group-wide assessment of any participation needs to determine whether there are existing or potential impediments to the effective transfer of capital within the group. This may lead supervisors to judge that, although aggregate group-wide capital meets or exceeds capital requirements of the group, impediments or restrictions to intra-group transfers could result in capital shortfall at the group level. Such an assessment should take into account restrictions (eg legal, tax, rights of other shareholders' and policyholders' interests, restrictions that may be imposed by solo regulation of dependants, foreign exchange, specific local requirements for branch operations) on the transferability of excess regulatory capital (whether by the transfer of assets or by other means) in such dependants.

**Liquidity**

- 20. Supervisors should require that the head of the financial conglomerate adequately and consistently identify, measure, monitor, and manage its liquidity risks and the liquidity risks of the financial conglomerate. Supervisors should require that liquidity be sufficient across the financial conglomerate to meet funding needs in normal times and periods of stress.**

***Implementation criteria***

- 20(a) Supervisors should require that the head of the financial conglomerate develops and maintains liquidity management processes and funding programs that are consistent with the complexity, risk profile, and scope of operations of the financial conglomerate.
- 20(b) Supervisors should require that liquidity risk management processes and funding programs take into full account lending, investment, and other activities, and ensure that adequate liquidity is maintained at the head and each constituent entity within the financial conglomerate. Processes and programs should fully incorporate real and potential constraints, including legal and regulatory restrictions, on the transfer of funds among these entities and between these entities and the head.
- 20(c) Supervisors should require that liquidity risks are managed with: 1) effective governance and management oversight as appropriate; 2) adequate policies, procedures, and limits on risk taking; and 3) strong management information systems for measuring, monitoring, reporting, and controlling liquidity risks.

***Explanatory comments***

- 20.1 Where a financial conglomerate is part a wider group, supervisors should have timely access to information concerning the wider group's liquidity position and risks to that liquidity position, to enable the evaluation of the adequacy of the liquidity position of the financial conglomerate in the context of its relationship to the wider group.
- 20.2 Conglomerates should develop and maintain liquidity management processes and funding programs that are consistent with their complexity, risk profile, and scope of

operations. Appropriate liquidity risk management is especially important since liquidity difficulties can easily spread to subsidiaries, particularly in cases of similarly named companies where customers may not always understand the legal distinctions between constituent entities.

20.3 Entities that directly access market sources of funding and/or manage specific funding programs should pay particular attention to:

- maintaining sufficient liquidity, cash flow, and capital strength to service debt obligations and cover fixed charges;
- assessing the potential that funding strategies could undermine public confidence in the liquidity or stability of constituent entities; and
- ensuring the adequacy of policies and practices addressing the stability of funding and integrity of the institution's liquidity risk profile as evidenced by funding mismatches and the degree of dependence on potentially volatile sources of short-term funding.

20.4 Risks undertaken are expected to be managed with:

- effective governance and management oversight as appropriate;
- adequate policies, procedures, and limits on risk taking; and
- strong management information systems for measuring, monitoring, reporting, and controlling liquidity risks.

20.5 Supervisors should have adequate access to the information necessary to maintain an understanding and assessment of these functions.

## V. Risk Management

Since financial conglomerates are in the business of risk-taking, good risk management is a crucial focus of supervision. This section provides principles for the sound and comprehensive supervision of risk management frameworks in financial conglomerates. It covers factors ranging from risk culture and tolerance, to the use of stress and scenario testing and the monitoring of risk concentrations.

### **Risk management framework**

**21. Supervisors should require that an independent, comprehensive and effective risk management framework, accompanied by a robust system of internal controls, effective internal audit and compliance functions, is in place for the financial conglomerate.**

### **Implementation criteria**

21(a) Supervisors should ensure that the risk management framework is comprehensive, consistent across entities supervised in all sectors and covers the risk management function, risk management processes and governance, and systems and controls.

### *Risk management function*

- 21(b) Supervisors should require that the risk management function is independent from the business units and has a sufficient level of authority and adequately skilled resources to carry out its functions.
- 21(c) Supervisors should require that the risk management function generally has a direct reporting line to the board and senior management of the financial conglomerate.
- 21(d) Supervisors should, where they consider it appropriate, require that a separate risk management committee at the board of directors level is established by the financial conglomerate.

### *Risk management governance*

- 21(e) Supervisors should require that the board of the head of the financial conglomerate has overall responsibility for the financial conglomerate's group-wide risk management, internal control mechanism, internal audit and compliance functions to ensure that the group conducts its affairs with a high degree of integrity.
- 21(f) Supervisors should require that the financial conglomerate has an established enterprise-wide risk management process for, among others, periodically reviewing the effectiveness of the group-wide risk management framework and for ensuring appropriate aggregation of risks.
- 21(g) Supervisors should require that the risk management process cover identification, measurement, monitoring and controlling of risk types (eg credit risk, operational risk, strategic risk, liquidity risk) and these be linked where appropriate to specific capital requirements.

### *Systems and controls*

- 21(h) Supervisors should require that financial conglomerates have in place adequate, sound and effective risk management processes and internal control mechanisms at the level of the financial conglomerate, including sound administrative and accounting procedures.
- 21(i) Supervisors should require that risk management processes and internal control mechanisms of a financial conglomerate are appropriately documented and, at a minimum, take into account the:

- nature, scale and complexity of its business;
- diversity of its operations, including geographical reach ;
- volume, frequency and size of its transactions;
- degree of risk associated with each area of its operation;
- interconnectedness of the entities within the financial conglomerate (using intra-group transactions and exposures reporting as one measure); and
- sophistication and functionality of information and reporting systems.

### ***Explanatory comments***

- 21.1 Financial conglomerates, irrespective of their particular mix of business lines or financial sectors, are in the business of risk taking. Therefore, strong risk management is of paramount importance.



- 21.2 The comprehensive risk management framework and process should include board and senior management oversight.
- 21.3 In identifying, evaluating, monitoring, controlling and mitigating material risks (from regulated and unregulated activities), financial conglomerates should consider the prospect for these to change over time and prepare themselves accordingly.
- 21.4 The risk management processes and internal control mechanisms of a financial conglomerate should include clear arrangements for delegating authority and responsibility; segregation of the functions that involve committing the financial conglomerate's funds and accounting for assets and liabilities; reconciliation of these processes; safeguarding of the financial conglomerate's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.

#### **Risk management culture**

- 22. Supervisors should require that the financial conglomerate have in place processes and procedures to engender an appropriate group-wide risk management culture.**

#### **Implementation criteria**

- 22(a) Supervisors should require that financial conglomerates have in place processes and procedures for promoting an appropriate risk management culture including providing staff with risk management training, independence and appropriate incentives.
- 22(b) Supervisors should require that a financial conglomerate's approach to engendering an appropriate risk management culture cover awareness of risks posed by unregulated entities and unregulated financial products.
- 22(c) Supervisors should require financial conglomerates to provide appropriate risk management training to staff, and in particular to board members, senior management, and key persons in control functions.
- 22(d) Supervisors should require financial conglomerates have in place whistle-blowing procedures that encourage staff members to come forward when they are aware of non-observance with established risk management and compliance procedures.

#### **Explanatory comments**

- 22.1 The standard for the risk management culture should be directed and led by the board and senior management of the financial conglomerate. It is important that senior management demonstrate an appropriate risk management culture that takes into account the entirety of the financial conglomerate's business (regulated and unregulated, on and off-balance sheet). The culture should also invite credible challenge by willing and informed board members.
- 22.2 The governance structure as well as the risk management culture should support the requirement that the risk management function be independent, free from undue or inappropriate influence from the business line. The risk function should have sufficient stature within the organisation to effectively challenge the business line, and to maintain its independent review of the financial conglomerate's broader risk

management controls, processes and systems. Good risk culture attributes also include a strong history of rectifying audit and regulator issues and encouragement to escalate bad news promptly.

- 22.3 Senior managers should espouse prudent risk taking and respect the independent role of the risk management function.
- 22.4 Risk management considerations should be part of decision-making at all levels of a financial conglomerate, including at product design stage.

#### **Risk tolerance levels and risk appetite policy**

**23. Supervisors should require that the financial conglomerate establishes appropriate board approved, group-wide risk tolerance levels and a risk appetite policy.**

#### **Implementation criteria**

- 23(a) Supervisors should require that key staff, senior management and the board of the head of the financial conglomerate be aware of and understand the financial conglomerate's risk tolerance levels and risk appetite policy.
- 23(b) Supervisors should require that the financial conglomerate identify and measure against risk tolerance limits (and in line with its risk appetite policy) the risk exposure of the financial conglomerate on an on-going basis in order to identify potential risks as early as possible. This may include looking at risks by territory, by line of business, or by financial sector.

#### **Explanatory comments**

- 23.1 Financial conglomerates should establish risk tolerance levels and a risk appetite policy which set the tone for acceptable and unacceptable risk taking. This should be aligned with the financial conglomerate's business strategy, risk profile and capital plan.
- 23.2 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. The financial conglomerate's risk appetite policy is re-assessed regularly with respect to new business opportunities, changes in risk capacity and tolerance, and operating environment.

#### **New business**

**24. Supervisors should require that the financial conglomerate carries out a robust risk assessment when entering into new business areas.**

#### **Implementation criteria**

- 24(a) Supervisors should, where they consider it appropriate, review the risk assessment carried out by a financial conglomerate in the context of entering into new business.

- 24(b) Supervisors should require that financial conglomerates not expand into new products unless they have put in place adequate processes, controls and systems (such as IT) to manage them.
- 24(c) Supervisors should make sure that a financial conglomerate carries out the ongoing risk assessment after entering into new business areas.

***Explanatory comments***

- 24.1 At the time of assessing whether or not to enter into a new business area or product line, it is imperative that financial conglomerates undertake risk assessments and analyses to identify potential risks inherent in the new activity.
- 24.2 They should seek to understand the potential interaction between the risks of the new activity and the existing risk profile of the financial conglomerate. This should include a consideration of whether the new activity could adversely affect the risk appetite or risk tolerance of the financial conglomerate.

**Outsourcing**

- 25. Supervisors should require that, when considering whether to outsource a particular function, the financial conglomerate carries out an assessment of the risks of outsourcing, including the appropriateness of outsourcing a particular function.**

**Implementation criteria**

- 25(a) Supervisors should require that financial conglomerates have processes and criteria in place to review decisions to outsource a function in order to ensure that such outsourcing does not imply delegation of responsibility for that function.
- 25(b) Supervisors should be satisfied that the decision to outsource a function does not impede effective group-wide supervision of the financial conglomerate.

***Explanatory comments***

- 25.1 It is important that supervisors be satisfied that, when considering whether to outsource a particular function, financial conglomerates have considered the risks involved and the appropriateness of outsourcing a particular function. This includes considering the appropriateness of outsourcing to a particular provider and the cumulative risks of all outsourced functions. The supervisor should require the financial conglomerate to review the provider in advance to ensure it is in a position to provide the services, comply with the contractual terms, and observe all applicable laws and regulations.
- 25.2 Supervisors should periodically assess the outsourced function with regard to policy compliance, risk management measures and control procedures.
- 25.3 Outsourcing should never result in a delegation of responsibility for a given function. There may be certain functions within financial conglomerates which should not be outsourced under any circumstances, while there may be some that may only be outsourced if certain safeguards are put in place.

### **Stress and scenario testing**

- 26. Supervisors should require, where appropriate, that the financial conglomerate periodically carries out group-wide stress tests and scenario analyses for its major sources of risk.**

#### ***Implementation criteria***

- 26(a) Supervisors should require that stress tests are sufficiently severe, forward looking and flexible. They should cover an appropriate set of business activities and include a variety of different types of tests such as sensitivity analyses, scenario analyses and reverse stress testing.
- 26(b) Supervisors should require the financial conglomerate to document its stress and scenario tests, including reverse stress tests. Stress tests should be conducted under a robust governance framework that encompasses policies, procedures, and adequate documentation of procedures as well as validation of results.
- 26(c) Supervisors should require that the group-wide stress tests and scenario analyses conducted by the financial conglomerate are appropriate to the nature, scale and complexity of those major sources of risk and to the nature, scale and complexity of the financial conglomerate's business.
- 26(d) Supervisors should require that group-wide stress tests and scenario analyses include a group-wide approach (which takes account of the interaction between different parts of the group and different risk types) and consider the results of sectoral stress tests.
- 26(e) Supervisors should require that, when carrying out reverse stress tests, a financial conglomerate identifies a range of adverse circumstances which would cause its business to fail and assess the likelihood of such events crystallising.

#### ***Explanatory comments***

- 26.1 A financial conglomerate should have a good understanding of correlation between its respective sectors and the heterogeneity of such risks when conducting its stress tests. Stress tests should be robust and should consider sufficiently adverse circumstances. The group-wide stress test analysis should measure and evaluate the potential impact on individual entities.
- 26.2 Attention should be paid to covering all risks, including off-balance sheet items. For example, a financial conglomerate's stress tests and scenario analyses should take into account the risk that the financial conglomerate may have to bring back on to its consolidated balance sheet the assets and liabilities of off-balance sheet entities as a result of reputational contagion, notwithstanding the appearance of legal risk transfer.
- 26.3 Where reverse stress tests reveal a risk of business failure that is unacceptably high relative to the financial conglomerate's risk appetite or risk tolerance, the financial conglomerate should evaluate and adopt, where appropriate, effective arrangements, processes, systems or other measures to prevent or mitigate that risk.

### **Risk aggregation**

- 27. Supervisors should require that the financial conglomerate aggregate the risks to which it is exposed in a prudent manner.<sup>16</sup>**

#### ***Implementation criteria***

- 27(a) Supervisors should require that financial conglomerates not make overly ambitious diversification assumptions or imprudent correlation claims, particularly for capital adequacy and solvency purposes.
- 27(b) Supervisors should require financial conglomerates to have adequate resources and systems (including IT) for the purpose of aggregating risks.

#### ***Explanatory comments***

- 27.1 Risk aggregation should include a clear understanding of assumptions and be robust enough to support a comprehensive assessment of risk.
- 27.2 While it is possible that the spread of activities within a financial conglomerate may create diversification effects and reduce correlation, it is also true that membership of a financial conglomerate group may create “group risks” in the form of financial contagion, reputational contagion, ratings contagion (where a subsidiary accesses capital through a parent’s credit rating and then suffers stress following the utilisation of the capital), double/multiple-gearing (use of same capital more than once within a group), excessive leveraging (upgrade in the quality of capital as it moves through a group), and regulatory arbitrage (it is important that risks are assessed at the financial conglomerate level as well as at the level of its constituent parts).

### **Risk concentrations and intra-group transactions and exposures**

- 28. Supervisors should require that the financial conglomerate has in place effective systems and processes to manage and report group-wide risk concentrations and intra-group transactions and exposures.**

#### ***Implementation criteria***

- 28(a) Supervisors should require that the financial conglomerate has in place effective systems and processes to identify, assess and report group-wide risk concentrations (including for the purposes of monitoring and controlling those concentrations).
- 28(b) Supervisors should require that the financial conglomerate has in place effective systems and processes to identify, assess and report significant intra-group transactions and exposures.

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<sup>16</sup> Refer to Joint Forum report, “Developments in Risk Aggregation Modelling”, October 2010, [www.bis.org/publ/joint25.pdf](http://www.bis.org/publ/joint25.pdf)

- 28(c) 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.
- 28(d) Supervisors should consider setting quantitative limits and adequate reporting requirements.

### ***Explanatory comments***

- 28.1 Supervisors should ensure that financial conglomerates are managing their risk concentrations and intra-group transactions and exposures satisfactorily.
- 28.2 Supervisors should encourage adequate public disclosure of risk concentrations and intra-group transactions and exposures.
- 28.3 Supervisors should liaise closely with one another to ascertain each other's concerns and coordinate as deemed appropriate any supervisory action relative to risk concentrations and intra-group transactions and exposures within the financial conglomerate.
- 28.4 Supervisors should deal effectively with material risk concentrations and intra-group transactions and exposures that are considered to have a detrimental effect on the regulated entities or the financial conglomerate as a whole.

### **Off-balance sheet activities**

- 29. Supervisors should require that off-balance sheet activities, including special purpose entities, are brought within the scope of group-wide supervision of the financial conglomerate, where appropriate.<sup>17</sup>**

### ***Implementation criteria***

- 29(a) Supervisors should require that there is a process for determining whether the nature of the relationship between the financial conglomerate and a special purpose entity (SPE) requires the SPE to be fully or proportionally consolidated into the financial conglomerate for regulatory purposes.
- 29(b) Supervisors should require that the financial conglomerate's stress tests and scenario analyses take into account the risk associated with off balance sheet activities.
- 29(c) Supervisors should require that the overall nature of the relationship between the financial conglomerate and the SPE is considered including the risk of contagion from the SPE. This assessment should go beyond traditional control and influence relationships.

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<sup>17</sup> Refer to the Joint Forum "Report on Special Purpose Entities", September 2009, [www.bis.org/publ/joint23.pdf](http://www.bis.org/publ/joint23.pdf)

### ***Explanatory comments***

- 29.1 A financial conglomerate's risk management framework and processes should cover the full spectrum of risks to the financial conglomerate. This includes risks from regulated and unregulated entities, including SPEs and off-balance sheet activities.
- 29.2 The fact that a financial conglomerate does not own or control the SPE in the traditional sense should not mean that it should not be consolidated. Other channels of contagion should be considered, such as the provision of (actual or contingent) liquidity support, reputational risk, and whether the assets of the SPE previously belonged to the financial conglomerate or were third-party assets.
- 29.3 It is important that financial conglomerates assess all economic risks and business purposes of an SPE throughout the life of a transaction, distinguishing between risk transfer and risk transformation. Financial conglomerates should be particularly aware that, over time, the nature of these risks can change. Supervisors should require such assessment to be ongoing and that management has sufficient understanding of the risks.
- 29.4 Financial conglomerates should have the capability to aggregate, assess and report all their SPE exposure risks in conjunction with all other firm-wide risks.
- 29.5 Supervisors should regularly oversee and monitor the use of all SPE activity and assess the implications for the financial conglomerate of the activities of SPEs, in order to identify developments that can lead to systemic weakness and contagion or that can exacerbate pro-cyclicality.

## Annex 1

### Detailed mapping between the 1999 Principles and the 2012 Principles for the Supervision of Financial Conglomerates

| 1999 Principles for the Supervision of Financial Conglomerates | 2012 Principles for the Supervision of Financial Conglomerates | Observations  |
|--|--|---|
| <b>Capital Adequacy Paper</b>                                  |  |   |
|  |  | <p>The Joint Forum's 1999 <i>Capital Adequacy Principles</i> have been updated to reflect the recommendations contained in the DNSR report.</p> <ul style="list-style-type: none"> <li>• The <i>Capital Adequacy Principles</i> paper mentions three points not kept in the 2012 Principles as they relate rather to detailed guidance: <ul style="list-style-type: none"> <li>- It identifies three techniques of capital measurements (see paragraphs under “Techniques” as well as Annexes 1 and 2 to the <i>Capital Adequacy Principles</i> paper);</li> <li>- It sets out that when it is not possible to make a prudent valuation of the capital in a regulated dependent, the value of the participation should be deducted (see paragraph under “Total deduction”);</li> <li>- It identifies market risk as an “emerging issue” that may lead supervisors to consider that the full offset of positions is not appropriate and that an aggregation or deductive approach may give the best</li> </ul> </li> </ul> |



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|---|--|--|
|   |  | <p>group-wide assessment of risks (see paragraph under “Market risk”).</p> <ul style="list-style-type: none"> <li>The 1999 Principles are also more detailed on majority and minority interests (See the related paragraphs in the 1999 Principles).</li> </ul>  |
| I. Detect and provide for situations of double or multiple gearing, ie where the same capital is used simultaneously as a buffer against risk in two or more legal entities   | 17. Supervisors should require that capital adequacy assessment and measurement techniques consider double or multiple gearing.  | In substance the two sets of Principles are equivalent (see the 2012 Implementation Criteria and the explanations following the 1999 Principles).  |
| II. Detect and provide for situations where a parent issues debt and down streams the proceeds in the form of equity, which can result in excessive leverage  | 18. Supervisors should require that capital adequacy assessment and measurement techniques address excessive leverage and situations where a parent issues debt and down-streams the proceeds in the form of equity to a subsidiary.   | In substance the two sets of Principles are equivalent. The 2012 Principles update the 1999 Principles. The Explanatory Comments are almost the same as the comments that follow the 1999 Principle on excessive leverage situations.  |
| III. Include a mechanism to detect and provide for the effects of double, multiple or excessive gearing through unregulated intermediate holding companies which have participations in dependants or affiliates engaged in financial activities ( <i>Capital Adequacy</i> )                | 16. Supervisors should require that the capital adequacy assessments undertaken by the financial conglomerate consider group-wide risks, including those undertaken by unregulated entities within a financial conglomerate, and that these assessments soundly address third party participations and minority interests. | <p>In the 2012 Principles, capital adequacy assessments of banks should take into account the risks taken by both regulated and unregulated entities for all types of group-wide risks (not only the risk of double gearing). Furthermore, in the 2012 Principles, the notion of “unregulated entities” (see Part 3 “Scope of Application”) is wider than in the 1999 Principles where it is limited to entities “that are carrying out activities similar to the activities of entities regulated for solvency purposes”.</p> <p>The 1999 Principle on minority and majority interests is more detailed than the 2012 Principles (See the explanations following the 1999 Principle).</p> |
| IV. Include a mechanism to address the risks being accepted by unregulated entities within a financial conglomerate that are carrying out activities similar to the activities of entities regulated for solvency purposes (eg leasing, factoring, reinsurance) ( <i>Capital Adequacy</i> ) |  |  |
| V. Address the issue of participations in regulated dependants (and in unregulated dependants covered by Principle IV) and  |  |  |

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|---|--|---|
| to ensure the treatment of minority and majority interests is prudentially sound. |  |   |
| <b>Fit and Proper Principles</b>  |  |   |
|   |  | <p>In substance the two sets of Principles are equivalent. Key persons of a financial conglomerate (shareholders, managers, directors) that exert a material influence shall have soundness and integrity. In both sets of Principles, qualification tests should be run and supervisors should communicate with themselves when the financial conglomerate's key persons do not meet the fitness requirements (in the 2012 Principles, these requirements are part of the Explanatory Comments).</p> <p>However, please note that:</p> <ul style="list-style-type: none"> <li>- The 1999 <i>Fit and Proper Principles</i> paper addresses the issue of legislative and regulatory differences across countries (see paragraph 14 of the <i>Fit and Proper Principles</i>: "fitness, propriety or other qualification tests should be applied to directors in light of their role and responsibilities"), a point not kept in the 2012 Principles.</li> <li>- The 2012 Principles elaborate on the concept of "financial soundness" not mentioned in the 1999 Principles (see Implementation Criteria 11(b) and Explanatory Comment 11.2)</li> <li>- The 1999 Principles request mechanisms to be in place to ensure that supervisors are advised, at the authorisation stage, of the persons who can exert a material</li> </ul> |

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|  |  | <p>influence and that they are notified of any change (see the last paragraph of the <i>Fit and Proper Principles</i>).</p> <ul style="list-style-type: none"> <li>- The 1999 <i>Fit and Proper Principles</i> paper has been turned into a single Principle (including Implementation Criteria and Explanatory Comments) in the 2012 Principles.</li> </ul> <p>Furthermore, the 1999 Principles impose requirements on supervisors and financial conglomerates while the 2012 Principles often set up an objective (use of the words “should seek to” instead of “should require”).</p> |
| <p>1. In order to assist in ensuring that the regulated entities within financial conglomerates are operated prudently and soundly, fitness and propriety or other qualification tests should be applied to managers and directors of other entities in a conglomerate if they exercise a material or controlling influence on the operations of regulated entities.</p> | <p><b>Suitability of board members, senior management and key persons</b></p> <p>Supervisors should seek to ensure that the board members, senior managers and key persons in control functions in the various entities in a financial conglomerate possess integrity, competence, experience and qualifications to fulfil their role and exercise sound objective judgment.</p> | <p>The 2012 Principles reaffirm the 1999 Principles on suitability. However, it does not provide as many details as the 1999 Principles on fitness and propriety factors (see paragraphs under “Principal elements of fit and proper criteria” in the <i>Fit and Proper Principles</i> paper) as they rather relate to detailed guidance.</p>  |
| <p>2. Shareholders whose holdings are above specified thresholds and/or who exert a material influence on regulated entities within that conglomerate should meet the fitness, propriety or other qualification tests of supervisors.</p>  |  |  |
| <p>3. Fitness, propriety or other qualification tests should be applied at the authorisation stage and thereafter, on the occurrence of specified events.</p>  | <p>12(a) Supervisors should be satisfied of the suitability of board members, senior managers and key persons in control functions.</p>  | <p>In substance the two sets of Principles are equivalent. Fitness requirements should be met on an ongoing basis.</p>   |

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| <p>4. Supervisors' expectations are that the entities will take the measures necessary to ensure that fitness, propriety or other qualification tests are met on a continuous basis.</p>  | <p>12(b) Supervisors should require financial conglomerates to have satisfactory processes for periodically assessing suitability.</p> <p>12(c) Supervisors should require that the members of the boards of the head of the financial conglomerate and of its significant subsidiaries act independently of parties and interests external to the wider group; and that the board of the head of the financial conglomerate include a number of members acting independently of the wider group (including owners, board members, executives, and staff of the wider group).</p>  |  |
| <p>5. Where a manager or director deemed to exercise a material influence on the operations of a regulated entity is or has been a manager or director of another regulated entity within the conglomerate, the supervisor should endeavour to consult the supervisor of the other regulated entity as part of the assessment procedure.</p> <p>6. Where a manager or director deemed to exercise a material influence on the operations of a regulated entity is or has been a manager or director of an unregulated entity within the conglomerate, the supervisor should endeavour to consult with the supervisors of other regulated entities that have dealings with the unregulated entity as part of the assessment procedure.</p> | <p>12.2 Supervisors of regulated entities of the financial conglomerate are subject to statutory and other requirements in applying suitability tests to these entities in their jurisdiction. The organisational and managerial structure of financial conglomerates adds elements of complexity for supervisors seeking to ensure the suitability of persons. For instance, the management of regulated entities within the financial conglomerate can be extensively influenced by persons who are not directly responsible for such control functions. A group-wide perspective regarding suitability of persons is intended to close any loopholes in this respect. Supervisors may rely on assessments made by other relevant supervisors in this area regarding suitability. Alternatively they may decide on concerted</p> | <p>In substance the two sets of Principles are equivalent. Supervisors should communicate among themselves on suitability.</p> |

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| 7. Supervisors should communicate with the supervisors of other regulated entities within the conglomerate when managers, directors or key shareholders are deemed not to meet their fitness, propriety or other qualification tests.          | supervisory actions regarding suitability if required.  |   |
| <b>Principles for supervisory information sharing Paper</b>  |   |   |
|  | <b>Supervisory cooperation, coordination and information sharing</b><br>6. Supervisors should establish a process to confirm the roles and responsibilities of each supervisor in supervising the financial conglomerate, and to ensure efficient and effective information sharing, cooperation and coordination in the supervision of the financial conglomerate. | The 2012 Principles reaffirm the importance of the 1999 Principles on <i>supervisory information sharing</i> and <i>coordination</i> and call for a process to be established in order to organise the cooperation and to confirm the roles and responsibilities of each supervisor (see Implementation Criteria for more details).<br>The 1999 Principles provide more details than the 2012 Principles on how information should be shared (see detailed explanations following each Principle of the <i>Supervisory Information Sharing Paper</i> ) and which kind of information should be shared (see Annex 1 of the <i>Coordinator Paper</i> ). |
| 1. Sufficient information should be available to each supervisor, reflecting the legal and regulatory regime and the supervisor's objectives and approaches, to effectively supervise the regulated entities residing within the conglomerate. |   | The 2012 Principles do not give details on which pieces of information should be shared as they rather relate to detailed guidance. See detailed explanations following the 1999 Principles.  |
| 2. Supervisors should be proactive in raising material issues and concerns with other supervisors. Supervisors should respond in a timely and satisfactory manner when such issues and concerns are raised with them.                          |   | The 1999 Principles insist on the notion of “timeliness”. They are also more details on how information should be shared (see the explanations following the Principles).   |

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| 3. Supervisors should communicate emerging issues and developments of a material and potentially adverse nature, including supervisory actions and potential supervisory actions, to the primary supervisor in a timely manner.   |   |  |
| 4. The primary supervisor should share with other relevant supervisors information affecting the regulated entity for which the latter have responsibility, including supervisory actions and potential supervisory actions, except in unusual circumstances when supervisory considerations dictate otherwise. | 6(f) Supervisors should ensure they are aware of and respect legal restrictions and onward sharing limitations, and have arrangements in place for protecting the confidentiality of information received from other supervisors.   | As opposed to the 1999 Principles (“except in unusual circumstances when supervisory considerations dictate otherwise”), the 2012 Principles do not envisage the situation where a supervisor, under certain circumstances, might not want to share information with others. However, the 2012 Principles call for supervisors to protect the confidentiality of the data they may receive from other supervisors. |
| 5. Supervisors should purposefully take measures to establish and maintain contact with other supervisors and to establish a climate of cooperation and trust amongst themselves.   | 6(c) Supervisors should take measures to establish coordination arrangements in order to enable effective group-wide supervision, including, as appropriate, sharing information, participating in supervisory colleges, cooperating in on-site and off-site supervision and stress testing and taking enforcement actions. | In substance the two sets of Principles are equivalent. Even though the call for participating in supervisory colleges, cooperating in on-site supervision and taking enforcement actions is new.  |

| Annex 1 to the Supervisory Information Sharing Paper: Ten Key Principles on Information Sharing  |   |  |
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|  |   | Both sets of Principles imbed the principles of information sharing in the legal framework. However, several details of the Ten Key Principles, issued by the G7 Finance Ministers in May 1998, have not been kept in the 2012 Principles. |
| <b>1. Authorisation to share and gather information:</b> Each Supervisor should have general statutory authority to share its own supervisory information with foreign supervisors, in response to requests, or when the supervisor itself believes it would be beneficial to do so. The decision about whether to exchange information should be taken by the Provider, who should not have to seek permission from anyone else. A provider should also possess adequate powers (with appropriate safeguards) to gather information sought by a Requestor | <b>Cooperation and information sharing</b><br>2. The legal framework should grant the necessary power and authority to supervisors to enable cooperation, coordination and information sharing among supervisors in order to facilitate effective group-wide supervision.   | In substance the two sets of Principles are equivalent. Both sets of Principles imbed the principles of information sharing in the legal framework.  |
| <b>2. Cross-sector information sharing:</b> Supervisors from different sectors of financial services should be able to share supervisory related information with each other both internationally (eg a securities supervisor in one jurisdiction and a banking supervisor in another) and domestically.   | <b>Supervisory cooperation, coordination and information sharing</b><br>6. Supervisors should establish a process to confirm the roles and responsibilities of each supervisor in supervising the financial conglomerate, and to ensure efficient and effective information sharing, cooperation and coordination in the supervision of the financial conglomerate. | In substance the two sets of Principles are equivalent. Information should flow between the different supervisors involved in the supervision of a financial conglomerate.   |
| <b>3. Information about systems and controls:</b> Supervisors should cooperate in identifying and monitoring the use of management and information systems,  |   | The 1999 Principles are more detailed than the 2012 Principles on the type of information that must be shared.   |

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| and controls, by internationally active firms.  |   |  |
| <b>4. Information about individuals:</b> Supervisors should have the authority to share objective information of supervisory interest about individuals such as owners, shareholders, directors, managers or employees of supervised firms.   |   |  |
| <b>5. Information sharing between exchanges:</b> Exchanges in one jurisdiction should be able to share supervisory information with exchanges in other jurisdictions, including information about the positions of their members.   |   |  |
| <b>6. Confidentiality:</b> A Provider should be expected to provide information to a Requestor that is able to maintain its confidentiality. The Requestor should be free to use such information for supervisory purposes across the range of its duties, subject to minimum confidentiality standards | 6(f) Supervisors should ensure they are aware of and respect legal restrictions and onward sharing limitations, and have arrangements in place for protecting the confidentiality of information received from other supervisors.   | In substance the two sets of Principles are equivalent.  |
| <b>7. Formal agreements and written requests:</b> The Requestor should not have to enter into a strict formal agreement in order to obtain information from a Provider. Nor should a written request be a prerequisite to the sharing of information, particularly in an emergency.                     | <b>Cooperation and information sharing</b><br>2. The legal framework should grant the necessary power and authority to supervisors to enable cooperation, coordination and information sharing among supervisors in order to facilitate effective group-wide supervision. | In substance the two sets of Principles are equivalent. The 2012 Principles elaborate on the 1999 Principles and call for :<br><ul style="list-style-type: none"> <li>- The legal framework to make the sharing of information and cooperation enforceable,</li> <li>- Supervisors to agree on a process for information sharing.</li> </ul> |
| <b>8. Reciprocity requirements:</b> These, too, should not be a strict precondition for the exchange of information, but the principle of reciprocity may be a consideration.   |   |  |



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| <p><b>9. Cases which further supervisory purposes:</b> In order to ensure the integrity of firms and markets, the Provider should permit the Requestor to pass on information for supervisory or law enforcement purposes to other supervisory and law enforcement agencies in its jurisdiction that are charged with enforcing relevant laws, in cases which further supervisory purposes.</p> | <p><b>Supervisory cooperation, coordination and information sharing</b></p> <p>6. Supervisors should establish a process to confirm the roles and responsibilities of each supervisor in supervising the financial conglomerate, and to ensure efficient and effective information sharing, cooperation and coordination in the supervision of the financial conglomerate.</p> |   |
| <p><b>10. Removal of laws preventing supervisory information exchange:</b> to facilitate cooperation between the supervisors of internationally-active groups, each jurisdiction should take steps to remove or modify those laws and procedures that prevent or impede the exchange of necessary supervisory information.</p>  | <p><b>Cooperation and exchange information sharing</b></p> <p>2. The legal framework should grant the necessary power and authority to supervisors to enable cooperation, coordination and information sharing among supervisors in order to facilitate effective group-wide supervision.</p>  | <p>In substance the two sets of Principles are equivalent. The legal framework should ease the sharing of information</p>   |
| <p><b>Coordinator Paper</b></p>   |  |   |
|   |  | <p>In both sets of Principles, the supervisor shall appoint a lead supervisor (the “Group-level Supervisor” in the 2012 Principles and the “coordinator” in the 1999 Principles) and decide on its responsibilities. However, the Coordinator Paper is more detailed than the 2012 Principles on how to choose the coordinator (see Annex 2 of the <i>Coordinator Paper</i>). The <i>Coordinator Paper</i> also provides details on the “elements of coordination” (see Annex 1 of the <i>Coordinator Paper</i>) which are not in the 2012 Principles.</p> <p>The 2012 Principles assign a wider scope to coordination (“ensuring effective and</p> |

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|  |   | comprehensive group-level supervision”) than the 1999 Principles which focus more on information sharing (even though Principle 4 of the <i>Coordinator Paper</i> mentions “any other form of coordination”). The call for participating in supervisory colleges, cooperating in on-site and off-site supervision and taking enforcement actions is new. The <i>Coordinator Paper</i> only mentions the “participation of the coordinator in on-site visits or examinations of an institution's foreign activities where legal and appropriate”. |
| 1. Arrangements between supervisors relating to the coordination process should provide for certain information to be available in emergency and non emergency situations.   | <b>Group-level Supervisor</b><br>5. Supervisors should ensure there is a clear process in place for coordinating various roles and responsibilities with clearly delineated responsibility for ensuring effective and comprehensive group-level supervision, including a coordination process to identify a group-level supervisor. | A process for coordination should be in place both in emergency and non-emergency situations. However, the 1999 Principles focus on supervisory information sharing, while the 2012 Principles adhere to an overall financial conglomerate-wide supervision principle.   |
| 2. The decision to appoint a coordinator and the identification of a coordinator should be at the discretion of the supervisors involved with the conglomerate.  | 5(a) There should be a clear and agreed upon coordination process for identifying the Group-level Supervisor.   |  |
| 3. Supervisors should have the discretion to agree amongst themselves the role and responsibilities of a coordinator in emergency and non-emergency situations.  | 5(b) The process for identifying a Group-level Supervisor should take account of the powers and authorities available to the relevant supervisors.  |  |
| 4. Arrangements for information flows between the coordinator and other supervisors and for any other form of coordination in emergency and nonemergency situations should be clarified in advance where possible. | 5(c) The identified coordination process should result in a single Group-level Supervisor with responsibility for effective group-level supervision and for facilitating coordination between relevant supervisors to enable effective group-wide supervision.  |  |

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| <p>5. Supervisors' ability to carry out their supervisory responsibilities should not be constrained by reason of a coordinator being identified and a coordinator assuming certain responsibilities.</p>  | <p>5.2 The determination of a Group-level Supervisor should take into account the powers and authorities available to the relevant supervisors and in many cases the Group-level Supervisor would likely be the supervisor that has responsibility for the supervision of the head of the financial conglomerate, carries out consolidated supervision or which is responsible for the largest part of the conglomerate.</p> | <p>In substance the two sets of Principles are equivalent. The existence of a Group-level Supervisor should not deprive the other supervisors from their rights and responsibilities. Please also note that Implementation Criteria 6(g) calls for "Arrangements for resolving differences between supervisors". As set in Explanatory Comment 6.7, "these differences may arise, for example, in relation to the undertaking of specific supervisory actions in relation to entities within the conglomerate or in the identification of the Group-level Supervisor."</p>        |
| <p>6. The identification of a coordinator and the determination of responsibilities for a coordinator should be predicated on the expectation that those responsibilities would enable supervisors to better carry out the supervision of regulated entities within financial conglomerates.</p> | <p>5.1 In order to ensure comprehensive group-wide supervision, there should be a single Group-level Supervisor, who is responsible for effective group-level supervision of the financial conglomerate, and for facilitating coordination between sectoral and other relevant supervisors to enable effective group-wide supervision.</p>   | <p>The 1999 Principles are more detailed on how to choose the coordinator.</p>  |
| <p>7. The identification and assumption of responsibilities by a coordinator should not create a perception that responsibility has shifted to the coordinator.</p>  | <p>5.2 The determination of a Group-level Supervisor should take into account the powers and authorities available to the relevant supervisors and in many cases the Group-level Supervisor would likely be the supervisor that has responsibility for the supervision of the head of the financial conglomerate, carries out consolidated supervision or which is responsible for the largest part of the conglomerate.</p> | <p>In substance the two sets of Principles are equivalent. The existence of a Group-level Supervisor should not deprive the other supervisors from their rights and responsibilities.</p> <p>Please also note that Implementation Criteria 6(g) calls for "Arrangements for resolving differences between supervisors". As set in Explanatory Comment 6.7, "these differences may arise, for example, in relation to the undertaking of specific supervisory actions in relation to entities within the conglomerate or in the identification of the Group-level Supervisor."</p> |

| Intra-group Transactions and Exposures Principles  |   |   |
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|  |   | <p>In substance the two sets of Principles are equivalent. The two sets of Principles are almost the same.</p> <p>However, please note that the 1999 Principles are more detailed on how these Principles should be applied: see comments following each 1999 Principle.</p> <ul style="list-style-type: none"> <li>- The 1999 Principles provide definitions of ITEs.</li> <li>- The 1999 Principles have been turned into Implementation Criteria and Explanatory Comments in the 2012 Principles.</li> </ul> |
| <p>I. Supervisors should take steps, directly or through regulated entities, to provide that conglomerates have adequate risk management processes in place, including those pertaining to ITEs, for the conglomerate as a whole. Where necessary the supervisors should consider appropriate measures, such as reinforcing these processes with supervisory limits.</p> | <p><b>Risk concentrations and intra-group transactions and exposures</b></p> <p>28. Supervisors should require that the financial conglomerate has in place effective systems and processes to manage and report group-wide risk concentrations and intra-group transactions and exposures.</p> <p>28(d) Supervisors should consider setting quantitative limits and adequate reporting requirements.</p> | <p>In substance the two sets of Principles are equivalent. <u>However, the 2012</u> Principles explicitly refer to intra-group transactions.</p>  |
| <p>II. Supervisors should monitor material ITEs of the regulated financial entities on a timely basis, as needed, through regular reporting or by other means to help form a clear understanding of the ITEs of the financial conglomerate</p>   | <p>28(b) Supervisors should require that the financial conglomerate has in place effective systems and processes to identify, assess and report significant intra-group transactions and exposures.</p> <p>28(c) Supervisors should require the financial conglomerate to report significant risk concentrations and intra-group transactions</p>   |   |

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|  | and exposures at the level of the financial conglomerate on a regular basis.   |  |
| III. Supervisors should encourage public disclosure of ITEs.   | 28.2 Supervisors should encourage adequate public disclosure of risk concentrations and intra-group transactions and exposures.  |  |
| IV. Supervisors should liaise closely with one another to ascertain each other's concerns and coordinate as deemed appropriate any supervisory action relative to ITEs within the group.                                       | 28.3 Supervisors should liaise closely with one another to ascertain each other's concerns and coordinate as deemed appropriate any supervisory action relative to risk concentrations and intra-group transactions and exposures within the financial conglomerate. |  |
| V. Supervisors should deal effectively and appropriately with material ITEs that are considered to have a detrimental effect on the regulated entities, either directly or through an overall detrimental effect on the group. | 28.4 Supervisors should deal effectively with material risk concentrations and intra-group transactions and exposures that are considered to have a detrimental effect on the regulated entities or the financial conglomerate as a whole.                           |  |
| <b>Risk Concentrations Principles</b>  |  |  |
|  |  | <p>In substance the two sets of Principles are equivalent.</p> <p>However, please note that:</p> <ul style="list-style-type: none"> <li>- The 1999 Principles are more detailed on how these Principles should be applied: see comments following each 1999 Principle.</li> <li>- The 1999 Principles provide definitions of RCs.</li> <li>- The 1999 Principles have been turned into implementation criteria and explanatory comments in the 2012 Principles.</li> </ul> |

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| <p>I. Supervisors should take steps, directly or through regulated entities, to provide that conglomerates have adequate risk management processes in place to manage group-wide risk concentrations. Where necessary the supervisors should consider appropriate measures, such as reinforcing these processes with supervisory limits</p> | <p><b>Risk concentrations and intra-group transactions and exposures</b></p> <p>28. Supervisors should require that the financial conglomerate has in place effective systems and processes to manage and report group-wide risk concentrations and intra-group transactions and exposures.</p> <p>28(d) Supervisors should consider setting quantitative limits and adequate reporting requirements.</p>  | <p>In substance the two sets of Principles are equivalent. However, the 2012 Principles expand to expressly capture intra-group transaction and exposures.</p> |
| <p>II. Supervisors should monitor material risk concentrations on a timely basis, as needed, through regular reporting or by other means to help form a clear understanding of the risk concentrations of the financial conglomerate.</p>   | <p>28(a) Supervisors should require that the financial conglomerate has in place effective systems and processes to identify, assess and report group-wide risk concentrations (including for the purposes of monitoring and controlling those concentrations).</p> <p>28(c) 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.</p> |  |
| <p>III. Supervisors should encourage public disclosure of risk concentrations</p>   | <p>28.2 Supervisors should encourage adequate public disclosure of risk concentrations and intra-group transactions and exposures.</p>   |  |
| <p>IV. Supervisors should liaise closely with one another to ascertain each other's concerns and coordinate as deemed appropriate any supervisory action relative to risk concentrations within the group</p>   | <p>28.3 Supervisors should liaise closely with one another to ascertain each other's concerns and coordinate as deemed appropriate any supervisory action relative to risk concentrations and intra-group transactions and exposures within the financial conglomerate.</p>  |  |

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| V. Supervisors should deal effectively and appropriately with material risk concentrations that are considered to have a detrimental effect on the regulated entities, either directly or through an overall detrimental effect on the group | 28.4 Supervisors should deal effectively with material risk concentrations and intra-group transactions and exposures that are considered to have a detrimental effect on the regulated entities or the financial conglomerate as a whole.                              |  |
| <b>New Principles</b>  |   |  |
|  | <b>I. Supervisory powers and authority</b>  | Section I of the 2012 Principles is directed to policymakers and can be viewed as preconditions for effective group-wide supervision of financial conglomerates. From this perspective it is new although some aspects relate to the 1999 <i>Principles for Supervisory Information Sharing</i> and the <i>Coordinator Paper</i> . |
|  | <b>Comprehensive group-wide supervision</b><br>1. The legal framework for the supervision of financial conglomerates should grant supervisors (including the Group-level Supervisor) the necessary powers and authority to enable comprehensive group-wide supervision. |  |
|  | <b>Independence and accountability</b><br>3. The legal framework should provide supervisors with operational independence while ensuring accountability for the discharge of their duties.  |  |
|  | <b>Resources</b><br>4. Supervisors of financial conglomerates should be adequately resourced in a manner that does not undermine their independence.  |  |

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|  | <b>II. Supervisory responsibility</b>  | Section II of the 2012 Principles is directed to supervisors and offers a more comprehensive view on their role and responsibilities than the 1999 Principles that focus on supervisory information sharing and coordination ( <i>Principles for supervisory information sharing Paper and Coordinator Paper</i> ).  |
|  | <b>Prudential standards and coverage</b><br>7. Supervisors should establish, implement and maintain a comprehensive framework of risk-based minimum prudential standards for financial conglomerates.                                  |  |
|  | <b>Monitoring and supervision</b><br>8. Supervisors should develop and maintain a sound understanding of the operations of financial conglomerates through undertaking a range of appropriate supervisory activities.                  |  |
|  | <b>Supervisory tools and enforcement</b><br>9. Supervisors should, when appropriate, utilise supervisory tools to compel timely corrective actions and/or enforce compliance of financial conglomerates with the prudential framework. |  |
|  | <b>III. Governance</b>   | The 1999 Principles on financial conglomerates do not address corporate governance in a general and broad manner. The most closely related existing Principles were drafted only through the narrow lens of "fit and proper" - a small subset of corporate governance. Therefore this section can be considered new. |



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|  | <b>Corporate governance in financial conglomerates</b><br>10. Supervisors should seek to ensure that the financial conglomerate establishes a comprehensive and consistent governance framework across the group that addresses the sound governance of the financial conglomerate, including unregulated entities, without prejudice to the governance of individual entities in the group. |  |
|  | <b>Structure of the financial conglomerate</b><br>11. Supervisors should seek to ensure that the financial conglomerate has a transparent organisational and managerial structure, which is consistent with its overall strategy and risk profile and is well understood by the board and senior management of the head company.   |  |
|  | <b>Responsibility of the board of the head of the financial conglomerate</b><br>13. Supervisors should require that the board of the head of the financial conglomerate appropriately defines the strategy and risk appetite of the financial conglomerate, and ensures this strategy is implemented and executed in the various entities, both regulated and unregulated                    | <p>In the 1999 Principles, there is no requirement in relation to the role and responsibilities of the board.</p> <p>In the 1999 Principles there is also no requirement in relation to the composition of the board (see 12(c) of the 2012 Principles).</p> |
|  | <b>Remuneration in a financial conglomerate</b><br>14. Supervisors should require that the financial conglomerate has and implements an appropriate remuneration policy that is consistent with its risk profile. The policy should take into account the material risks that  |  |

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|  | organisation is exposed to, including those from its employees' activities.  |   |
|  | <b>IV. Capital adequacy and liquidity</b>  | <p>The 2012 Principles are divided into three sections, one on capital management, one on capital assessment and one on liquidity adequacy.</p> <p>The 2012 Principles on capital assessment are based on the 1999 Joint Forum's <i>Capital Adequacy Principles</i>, and have been updated to reflect the recommendations contained in the DNSR report.</p> <p>The Principles on capital management and liquidity adequacy are new.</p> |
|  | <b>Capital management</b>  | Supervisors should ensure that financial conglomerates develop and follow appropriate policies to manage capital on a group-wide basis sufficient to help ensure the entity remains able to withstand a period of adverse conditions.   |
|  | <p>15. Supervisors should require that the financial conglomerate:</p> <p>15(i) maintains adequate capital on a group-wide basis to act as a buffer against the risks associated with the group's activities;</p> <p>15(ii) develops capital management policies that are approved and regularly reviewed by the board, and that include a clearly and formally documented capital planning process that ensures compliance with capital requirements on a group-wide and regulated entity basis; and</p> <p>15(iii) considers and assesses the group-wide risk profile when undertaking capital management.</p> |   |

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|  | <b>Capital assessment</b>   |  |
|  | 19. Supervisors should require that assessment and measurement techniques evaluate any limitations on intra-group transfers of capital, taking into account potential impediments to executing such transfers that could constrain their suitability for inclusion in the assessment of group capital.  |  |
|  | <b>Liquidity</b>  | Liquidity risk is mentioned several times in the 1999 Principles papers ( <i>Supervisory Questionnaire</i> and the <i>Risk Concentrations Principles</i> ). However, there was no general principle on the need for banks to properly manage their liquidity risk. |
|  | 20. Supervisors should require that the head of the financial conglomerate adequately and consistently identify, measure, monitor, and manage its liquidity risks and the liquidity risks of the financial conglomerate. Supervisors should require that liquidity be sufficient across the financial conglomerate to meet funding needs in normal times and periods of stress. |  |
|  | <b>V. Risk management</b>   | The 2012 Principles expand on the 1999 <i>Risk Concentrations Principles</i> and the <i>Intra-Group Transactions and Exposures Paper</i> to broadly set up principles for risk management.   |
|  | <b>Risk management framework</b><br>21. Supervisors should require that an independent, comprehensive and effective risk management framework, accompanied by a robust system of internal controls, effective internal audit and compliance functions, is in place for the financial conglomerate.  |  |

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|  | <b>Risk management culture</b><br>22. Supervisors should require that the financial conglomerate have in place processes and procedures to engender an appropriate group-wide risk management culture.  |  |
|  | <b>Risk tolerance levels and risk appetite policy</b><br>23. Supervisors should require that the financial conglomerate establishes appropriate board approved, group-wide risk tolerance levels and a risk appetite policy.  |  |
|  | <b>New business</b><br>24. Supervisors should require that the financial conglomerate carries out a robust risk assessment when entering into new business areas.   |  |
|  | <b>Outsourcing</b><br>25. Supervisors should require that, when considering whether to outsource a particular function, the financial conglomerate carries out an assessment of the risks of outsourcing, including the appropriateness of outsourcing a particular function. |  |
|  | <b>Stress and scenario testing</b><br>26. Supervisors should require, where appropriate, that the financial conglomerate periodically carries out group-wide stress tests and scenario analyses for its major sources of risk.  |  |

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|  | <b>Risk aggregation</b><br>27. Supervisors should require that the financial conglomerate aggregate the risks to which it is exposed in a prudent manner.   |  |
|  | <b>Off-balance sheet activities</b><br>29. Supervisors should require that off-balance sheet activities, including special purpose entities, are brought within the scope of group-wide supervision of the financial conglomerate, where appropriate. |  |

## Annex 2

### Joint Forum Working Group on Revising the Principles for the Supervision of Financial Conglomerates

| <b>Co-Chair</b> | <b>Olivier Prato<br/>Teresa Rutledge</b>   | <b>Autorité de Contrôle Prudentiel<br/>Office of the Comptroller of the Currency</b>   |
|-----------------|--|--|
| Australia       | Steven Bardy<br>Helen Rowell<br>Melisande Waterford                              | Australian Securities and Investments Commission<br>Australian Prudential Regulation Authority<br>Australian Prudential Regulation Authority |
| Belgium         | Veerle de Vuyst  | National Bank of Belgium   |
| Brazil          | Marcelo Colli Inglez<br>Paulo Sérgio Neves de Souza                              | Central Bank of Brazil<br>Central Bank of Brazil   |
| Canada          | Daniel Mayost<br>Judith Roberge  | OSFI<br>OSFI   |
| China           | Zhang Xiaopu   | China Banking Regulatory Commission  |
| France          | Emmanuel Carrère<br>Emilie Fialon  | Autorité de contrôle prudentiel<br>Autorité de contrôle prudentiel   |
| Germany         | Sina Weinhold-Koch<br>Sabine Otto  | BaFin<br>BaFin   |
| Italy           | Maria-Alessandra Freni   | Bank of Italy  |
| Japan           | Shintaro Nakamura<br>Akira Yasui<br>Kenji Hoki<br>Yuka Osuna<br>Tsuyoshi Saito   | Bank of Japan<br>Bank of Japan<br>Financial Services Agency<br>Financial Services Agency<br>Financial Services Agency                        |
| Korea           | Mr Hoon Huh  | Financial Supervisory Service  |
| Singapore       | Francis Quek   | Monetary Authority of Singapore  |
| Spain           | Roberto España<br>Marta Estavillo<br>José Gomez de Miguel<br>José Manuel Portero | Bank of Spain<br>Bank of Spain<br>Bank of Spain<br>CNMV  |
| Switzerland     | Urs Halbeisen  | FINMA  |
| United Kingdom  | Himali Hettihewa<br>Olu Omoyele  | Financial Services Authority<br>Financial Services Authority   |
| United States   | Meg Donovan<br>Robert Esson<br>Alexandria Luk                                    | Federal Reserve Board<br>National Association of Insurance Commissioners<br>Office of the Comptroller of the Currency                        |

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|-------------|---------------------|--|
|             | Mark Attar          | Securities and Exchange Commission                   |
| EC          | Linda Van Goor      | European Commission                                  |
| IMF         | Jennifer Elliott    | International Monetary Fund                          |
|             | Michael Moore       | International Monetary Fund                          |
| IAIS        | Lance Leatherbarrow | International Association of Insurance Supervisors   |
|             | Jeffery Yong        | International Association of Insurance Supervisors   |
| IOSCO       | Isabel Pastor       | International Organization of Securities Commissions |
| Secretariat | Paul Melaschenko    | Basel Committee/Joint Forum Secretariat              |