

Standard 1.5

Supervision of financial and insurance conglomerates

Regulations and guidelines



RAHOITUSTARKASTUS
FINANSINSPEKTIONEN
FINANCIAL SUPERVISION

TABLE OF CONTENTS

1 Application	4
2 Objectives	6
3 International framework	8
4 Legal basis	10
5 Key principles of supervision of financial and insurance conglomerates	11
5.1 Recognition of a conglomerate and its holding company	12
5.2 Supervision of the owners of the holding company	13
5.3 Fitness and propriety of the management of the holding company	13
5.4 Auditors' qualifications and reporting requirements	14
5.5 Financial statement and consolidated financial statement	14
5.6 Internal control	14
5.7 Sound governance	15
5.8 Intra-group transactions	15
5.9 Risk concentrations	16
5.10 Share and real estate holdings	16
5.11 Acquisition of control in an undetaking outside the European Economic Area	17
5.12 Disclosure of information on the conglomerate	17

6 Reporting to the Financial Supervision Authority	18
7 Further details	19

1 APPLICATION

*Issued on 17 June 2003
Valid from 15 August 2003*

(1) This standard applies to financial and insurance conglomerates supervised by the Financial Supervision Authority (FSA) primarily engaged in financial activities and including at least one Finnish credit institution or investment firm and at least one Finnish insurance company, provided that the share of neither sector is negligible. The standard applies to the operations of the parent company of such conglomerate. The concept of financial and insurance conglomerate is defined in section 3 of the Act on the Supervision of Financial and Insurance Conglomerates.¹

¹ *Act on the Supervision of Financial and Insurance Conglomerates, adopted on 25 January 2002, No. 44/2002 in the Statute Book of Finland*

Section 3. Financial and insurance conglomerate

A conglomerate shall comprise the parent company referred to in subsection 2 (parent company of the conglomerate) as well as undertaking of the financial and insurance branch:

- 1) over which the parent company of the conglomerate exercises control in the manner referred to in chapter 1, sections 5 and 6 of the Accounting Act (1336/1997)*
- 2) which has joint management with an undertaking referred to in this subsection, or*
- 3) which is managed on a unified basis with an undertaking referred to in this subsection.*

In applying paragraph 1 above, the holding shall also comprise a holding in an employee pension insurance company or pension fund referred to in section 7, subsections 2–5 below.

The parent company of a conglomerate shall mean:

- 1) a Finnish credit institution or investment firm which exercises control referred to in subsection 1, paragraph 1 over at least one Finnish insurance company or which has a relationship referred to in subsection 1, paragraph 2 or 3 to a Finnish insurance company with a smaller balance sheet total; and*
- 2) a Finnish insurance company which exercises control referred to in subsection 1, paragraph 1 at least over one Finnish credit institution or investment firm or which has a relationship referred to in subsection 1, paragraph 2 or 3 to a Finnish credit institution or investment firm with a smaller balance sheet total; and*
- 3) the holding company of the conglomerate.*

The holding company of the conglomerate shall mean a Finnish parent company, the subsidiaries of which as referred to in the Accounting Act include at least one Finnish credit institution or investment firm and one Finnish insurance company, and where the aggregate balance-sheet total of the balance sheets, last drawn up, of the financial and insurance

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(2) In addition to the standard on the supervision of financial and insurance conglomerates, sectoral legislation and other sectoral rules also apply to credit institutions, investment firms and insurance companies within a conglomerate.

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(3) The regulatory content of the standard is based on the Act on the Supervision of Financial and Insurance Conglomerates (hereinafter the Act). Under the Act, one principal responsible (coordinating) supervisory authority shall always be assigned to the financial and insurance conglomerate as specified in the grounds set out in the Act. The FSA shall act as the coordinating supervisory authority if the parent company of the conglomerate is a credit institution, investment firm or holding company in a conglomerate in which the share of the financial sector is larger than that of the insurance sector, as calculated under section 6, subsection 2, of the Act². If the conglomerate is primarily engaged in insurance activities or considered to engage in insurance activities under section 6, subsection 2, of the Act, the Insurance Supervisory Authority shall act as the coordinating supervisory authority and shall issue the regulations applicable to the conglomerate.

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(4) The provisions of the Act do not limit the rights and obligations of the other supervisory authority to supervise a member company of the conglomerate or other companies as provided in another act. The provisions of the Act do not restrict the supervisory authority's competence by virtue of other legislation.

branch undertakings which are its subsidiaries referred to in the Accounting Act, is more than half of the aggregate total of the balance sheets last drawn up of the holding company and of all its subsidiaries as referred to in the Accounting Act. A parent company which is a credit institution, an investment firm, an insurance company or an employee pension insurance company shall not, however, be deemed a holding company.

² *Act on the Supervision of Financial and Insurance Conglomerates, adopted on 25 January 2002, No. 44/2002 in the Statute Book of Finland*

Section 6. Exemptions from the scope of application of the Act.

Section 6, subsection 2: 'The share of the branch of all the undertakings in the financial and insurance branches belonging to the conglomerate shall be obtained by first calculating the ratio of the sum total of the balance sheets of the undertakings belonging to the branch to the sum total of the balance sheets of all the undertakings in the financial and insurance branches (ratio 1) and the ratio of the total requirement of own funds of all the undertakings in the financial and insurance branches belonging to the conglomerate (ratio 2) and by then calculating the arithmetical averages of ratios 1 and 2.'

2 OBJECTIVES

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(1) The standard sets out the key principles governing the supervision of financial and insurance conglomerates primarily engaged in financial activities, together with the main legal provisions and FSA standards applicable to conglomerates. The standard summarises the FSA's responsibilities as coordinating authority and the supervisory obligations arising from the Act in respect of the member companies of the conglomerate.

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(2) Existing administrative provisions are sectoral. For assessment of the conglomerate's risk bearing capacity, sectoral supervision must be supplemented by conglomerate-wide supervision. There are major risks and threats involved in risk concentrations between member companies of the conglomerate and intra-group transactions. They generally have a stronger effect on the financial performance and capital adequacy position of conglomerates than on corporate structures where banking and insurance operations are separate. In a conglomerate, sectoral restrictions may for example be set aside by making transfers between the balance sheets of individual companies in order to avoid an imminent violation of a prescribed limit.

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(3) The aim of the regulations on the supervision of financial and insurance conglomerates and of this standard is to

- prevent manipulative transfers between the balance sheets of member companies of the conglomerate affecting supervisory limits or restrictions
- prevent risks in financial and insurance operations
- regulate the monitoring of the conglomerate's financial position, internal control and risk management as well as intra-group transactions
- set additional requirements for the conglomerate as sectoral supervision alone may lead to a misassessment of the overall financial position of the financial and insurance conglomerate.

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(4) The reporting of major intra-group transactions and risk concentrations between member companies of conglomerates seeks to

- establish the effect of intra-group transactions in order to obtain a fair view of operations
- ensure that intra-group transactions do not weaken the capital adequacy, profitability or liquidity of the conglomerate or its member companies
- ensure that intra-group transactions do not cause potential problems to spread within the conglomerate from one business area to another
- ensure that intra-group transactions are not undertaken to avoid supervision or the obligation to comply with acts and administrative regulations.

3

INTERNATIONAL FRAMEWORK

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(1) This standard is based on the recommendations issued by the Joint Forum on Financial Conglomerates (Joint Forum) and the Directive of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate.

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(2) The Joint Forum was established to carry on the work of the Tripartite Group on regulations for conglomerates.³ In February 1999 the Joint Forum issued its principles for the supervision of international financial and insurance conglomerates.⁴ The main points are:

- In the calculation of capital adequacy requirements the principles for the assessment of capital adequacy are presented. There are three alternative techniques of capital measurement, ie
 - the building-block prudential approach
 - the risk-based aggregation method
 - the risk-based deduction method
- Fit and proper assessment of the conglomerate's management and other key personnel and owners shall be undertaken when authorisation is granted and whenever necessary thereafter.
- Supervised entities shall have the capacity to take measures to ensure continued maintenance of the appropriate level of fitness and propriety.

³ *Committees at the Bank for International Settlement (BIS), The Supervision of Financial Conglomerates, July 1995.*

⁴ *Documents jointly released by the Basle Committee on Banking Supervision, the International Organisation of Securities Commissions and the International Association of Insurance Supervisors: Supervision of Financial Conglomerates, papers prepared by the Joint Forum on Financial Conglomerates, February 1999.*

- International supervision of financial and insurance conglomerates is based on the free and open exchange of information between the authorities responsible for the supervision of the individual parts of the conglomerate.

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(3) The Directive of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council took effect on 11 February 2003.⁵ The Directive is to be implemented in national law by 11 August 2004.

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(4) The Directive is designed to introduce special rules on the prudential supervision of financial conglomerates. The relevant scope of application has been defined using the concept of financial conglomerate. The Directive seeks to guarantee that supervisory authorities have the means to undertake supervision of the capital adequacy of financial conglomerates and ensure compliance with capital adequacy requirements.

⁵ *Directive 2002/87/EC was published on 11 February 2003 in the Official Journal (OJEC L 035, 11/02/2003, p. 1). It shall be implemented in national law by 11 August 2004.*

4

LEGAL BASIS

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(1) The FSA's regulations on the supervision of financial and insurance conglomerates are based on the provisions contained in the relevant Act (44/2002). Provisions on the FSA's powers to issue further regulations are set out in section 13, subsection 3, section 14, subsection 2, section 15, subsection 1, paragraph 1 and section 20, subsection 1, of the Act.

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(2) The contents of the present Act are broadly in line with the proposal for a directive on the supplementary supervision of credit institutions, insurance undertakings and investment firms (see 3.3 above) issued in April 2001.

5

KEY PRINCIPLES OF SUPERVISION OF FINANCIAL AND INSURANCE CONGLOMERATES

Binding

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Valid from 15 August 2003

(1) The supervised conglomerate shall establish processes for risk control and risk assessment. A conglomerate-wide approach to risk assessment requires a risk management system embracing the entire conglomerate. The parent company of the conglomerate shall regularly report to the FSA major intra-group transactions and risk concentrations of member companies of the conglomerate, together with details of the conglomerate structure, consolidated financial statement and share and real estate holdings. For determination of the structure of the conglomerate, the parent company shall, on a regular basis, provide the FSA with basic details of the member companies of the conglomerate, as well as information on major owners, board members, managing directors and auditors and on any changes therein.

Justifications

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(2) On the basis of the regular reports of the parent company of a conglomerate primarily engaged in financial activities, the FSA undertakes an assessment of the commercial standing of the financial and insurance conglomerate and the effects of risk concentrations and intra-group transactions on the capital adequacy, profitability and liquidity of the conglomerate and its member companies.

Justifications

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(3) In its supervisory activities, the FSA focuses on the responsibility of the board of the parent company of the financial and insurance conglomerate for planning the conglomerate's strategies and business operations and for the establishment of internal control and risk management processes. Such responsibility of the highest governing body does not eliminate the independent responsibility of the boards of the member companies. The FSA is obliged to undertake an assessment of the owners and managers of the holding company as well as of management operations to the same extent, irrespective of whether the parent company has authorisation or not.

Justifications

Issued on 17 June 2003
Valid from 15 August 2003

(4) The supervision of conglomerates is largely based on the free and open exchange of information between supervisory authorities. Together, the authorities assess the relevance of the information obtained in the course of supervision, for example when considering the need for supplementary supervision of the conglomerate or a member company. This standard does not address the FSA's right to inspect and to obtain information under section 17 of the Act.

Justifications

Issued on 17 June 2003
Valid from 15 August 2003

(5) The FSA standards applicable to the parent companies of conglomerates primarily engaged in financial activities and issued in connection with the revision of the set of regulations are discussed below. The FSA standards may apply not only to the parent companies of conglomerates but also to credit institutions and investment firms within a conglomerate. The standards are the same in content as the regulations and guidelines issued by the Insurance Supervisory Authority to the parent companies of conglomerates primarily engaged in insurance activities. The FSA's current regulations and guidelines will continue to be applied to the parent companies of conglomerates instead of the relevant standard, as will all regulations and guidelines, until the relevant standards are issued.

5.1 Recognition of a conglomerate and its holding company

Binding

Issued on 17 June 2003
Voimassa: 1.7.2003

(6) Section 5 of the Act sets out provisions on the obligation of the parent company of a conglomerate to notify the FSA or the Insurance Supervision Authority promptly of the establishment or termination of a financial and insurance conglomerate. The parent company of the conglomerate is obliged to collect the information for the entire conglomerate and report it to the coordinating supervisory authority.

Justifications

Issued on 17 June 2003
Valid from 15 August 2003

(7) The swift exchange of information between the conglomerate and the coordinating supervisory authority is important as changes in the conglomerate structure may alter the proportional shares of the sectors, with subsequent changes in the scope of application of the provisions governing conglomerates.

Binding

Issued on 17 June 2003
Valid from 15 August 2003

(8) The FSA will, at a later date, issue a standard setting out the requirements for the contents of the notification concerning the establishment and termination of a conglomerate to be filed by the parent company.

5.2 Supervision of the owners of the holding company

Justifications

Issued on 17 June 2003
Valid from 15 August 2003

(9) The acquisition or ownership of a holding in a holding company must not jeopardise the sound and prudent conduct of the business operations of the holding company or conglomerate. For this reason, the authorities shall receive detailed information on the planned acquisition of shares and participations in the holding company if the acquisition represents at least 10% of the share, guarantee or cooperative capital or of the voting rights. The disclosure requirement applies to any individual planning to acquire a major holding as well as to the holding company itself, which shall disclose such changes in holdings of which it has been made aware.

Binding

Issued on 17 June 2003
Valid from 15 August 2003

(10) Section 8 of the Act addresses supervision of the owners of the holding company of the conglomerate. The FSA will, at a later date, issue standards setting out the disclosure requirements applicable to the acquisition of holdings and changes in holdings. Guideline 101.6 on the supervision by the Financial Supervision Authority of changes in the ownership of credit institutions and Regulation 203.15 on the reporting of voting rights and qualifying holdings will apply until the FSA issues the relevant standards.

5.3 Fitness and propriety of the management of the holding company

Binding

Issued on 17 June 2003
Valid from 15 August 2003

(11) Section 11 of the Act sets out the principles for management of the holding company of a conglomerate. The board and the managing director shall manage the holding company of a conglomerate in a professional manner and in line with sound and prudent business principles. Board members and the managing director shall furthermore be of good reputation and possess such general knowledge of the financial and insurance business as is deemed necessary with regard to the character and scope of the operations of the conglomerate. The FSA shall be promptly notified of any changes in board members or of managing director.

Binding

Issued on 17 June 2003
Valid from 15 August 2003

(12) The FSA will, at a later date, issue standards setting out the principles for and contents of fit and proper assessments. Guideline 101.10 on the contents of fit and proper assessments and on the reporting requirement, the FSA statement of 9 December 1998 on assessing the fitness and propriety of directors and managers of credit institutions (K/17/98/LLO) and Regulation 203.17 on written reporting on the fitness and propriety of owners, directors and managers in connection with changes will apply until the FSA issues the relevant standards.

5.4 Auditors' qualifications and reporting requirements

Binding
Issued on 17 June 2003
Valid from 15 August 2003

(13) Section 12 of the Act sets out provisions on the qualifications to be met by the auditors of the holding company of a conglomerate. The auditors shall notify the FSA promptly of any fact or decision concerning the holding company of the conglomerate of which they have become aware when performing their duties and which may be considered to violate the responsibilities of the holding company of the conglomerate under the Act, jeopardise the continuation of the activities of the holding company of the conglomerate or its subsidiaries or lead to the refusal to certify the accounts or to the expression of reservations.

Binding
Issued on 17 June 2003
Valid from 15 August 2003

(14) The FSA will, at a later date, issue a standard defining the contents of the auditor's report. The FSA statement of 2 May 1997 (K/2/97) on auditors' reports and on the notification to be filed under section 11 a of the Act on the Financial Supervision Authority will be applied until the FSA issues the relevant standard.

5.5 Financial statement and consolidated financial statement

Binding
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Valid from 15 August 2003

(15) The Council of State Decree No. 89/2002 sets out provisions on the consolidated financial statement of financial and insurance conglomerates.

5.6 Internal control

Binding
Issued on 17 June 2003
Valid from 15 August 2003

(16) Section 13 of the Act sets out provisions on the establishment of internal control and risk management processes. The parent company of the conglomerate is responsible for the formulation of risk management principles and other internal control and business principles for the financial and insurance conglomerate.

Justifications
Issued on 17 June 2003
Valid from 15 August 2003

(17) The governing body exercising supreme decision-making power in the parent undertaking (board of directors) shall supervise that controlled organisations adhere to the principles of internal control on a comprehensive basis. Such responsibility of the highest governing body does not, however, eliminate the responsibility of, for example, the board of a credit institution or insurance company operating as a subsidiary of the group for establishing processes of internal control within their own organisation.

Binding
Issued on 17 June 2003
Valid from 15 August 2003

(18) The FSA will, at a later date, issue a standard setting out the requirements for the contents of the report on risk concentrations in a conglomerate.

5.7 Sound governance

Binding
Issued on 17 June 2003
Valid from 15 August 2003

(19) Under section 13, subsection 3, of the Act, the coordinating supervisory authority may issue further regulations on the requirements to be set for sound governance (reliable administration). The FSA will, at a later date, issue a standard setting out the requirements for sound governance.

Justifications
Issued on 17 June 2003
Valid from 15 August 2003

(20) In practice, the requirements for sound governance include the FSA's guidance to the parent company of the conglomerate on the requirements for the composition and operations of governing bodies. A sound governance promotes the achievement of the goals set by the owners and board of directors of the parent company of the conglomerate, as well as business performance.

5.8 Intra-group transactions

Binding
Issued on 17 June 2003
Valid from 15 August 2003

(21) Under section 14 of the Act, the parent company of the conglomerate shall report intra-group transactions to the coordinating supervisory authority. The FSA will, at a later date, issue a standard on the contents of such report. Regulation 105.14/203.30 on reporting to the Financial Supervision Authority of intra-group transactions between companies in a banking or investment firm group, and between companies within a financial and insurance conglomerate will apply until the FSA issues the relevant standard.

Justifications
Issued on 17 June 2003
Valid from 15 August 2003

(22) Intra-group transactions may have a significant effect on the financial performance and capital adequacy position of individual companies within the conglomerate. They may also cause conflicts of interest between participants in transactions. To allow for supervision of intra-group transactions and their effects, separate reporting on intra-group transactions is required.

5.9 Risk concentrations

Binding
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Valid from 15 August 2003

(23) In order to monitor and control risk concentrations in a conglomerate, section 14 of the Act imposes an obligation on the parent company to regularly report risk concentrations in a conglomerate to the coordinating authority. According to the preamble of the Act, risk concentrations mean particularly exposures as referred to in section 69 of the Credit Institutions Act. The coordinating supervisory authority may also issue further regulations on geographical or sectoral risk concentrations. Risk concentrations refer to the consolidated large exposures of the conglomerate in the financial sector, to which come the risk concentrations in the insurance sector equivalent to large exposures. The counterparties of the financial and insurance sectors are also reported by industry.

Binding
Issued on 17 June 2003
Valid from 15 August 2003

(24) The FSA has issued standard RA4.1 (Reporting of large exposures and risk concentrations) on the reporting of a conglomerate's risk concentrations. The standard sets out provisions on the contents of the report to be filed with the FSA.

5.10 Share and real estate holdings

Binding
Issued on 17 June 2003
Valid from 15 August 2003

(25) In order to monitor and control the share and real estate holdings of the conglomerate, section 14 of the Act sets out provisions on the obligation of the parent company of the conglomerate to regularly report share and real estate holdings to the coordinating authority. In this context, shares mean particularly holdings in business companies as referred to in section 21 of the Credit Institutions Act (1607/1993). The parent company of the conglomerate shall annually file a report of the situation on 31 December and send one copy of the report to the FSA by 1 April the following year.

Binding
Issued on 17 June 2003
Valid from 15 August 2003

(26) The FSA will, at a later date, issue a standard setting out the contents of the report. Regulation 105.2 on the reporting of shares and real estate held by credit institutions and their consolidation groups will apply until the FSA issues the relevant standard.

5.11 Acquisition of control in an undertaking outside the European Economic Area

Binding
Issued on 17 June 2003
Valid from 15 August 2003

(27) Section 10 of the Act applies to the acquisition of control in an undertaking outside the European Economic Area. Corporate acquisitions affecting the structure of a financial and insurance conglomerate must not impair the exercise of supervision of the conglomerate by the authorities. A member company may not acquire control as referred to in the Accounting Act (1336/1997) in a credit institution, investment firm or insurance company domiciled in a country outside the European Economic Area, if it has not notified the coordinating authority of the acquisition in advance or if the coordinating authority has prohibited the acquisition within three months of receipt of the notification. The coordinating supervisory authority has the right to prohibit the acquisition if the provisions and administrative regulations applicable to the company to be acquired impair supervision of the conglomerate or if the legislation of the relevant country lacks provisions allowing for efficient supervision. Acquisition of control in a company as referred to here without approval from the authorities is punishable under law.

Binding
Issued on 17 June 2003
Valid from 15 August 2003

(28) The FSA will, at a later date, issue a standard setting out the contents of the notification to be filed under section 10 of the Act.

5.12 Disclosure of information on the conglomerate

Binding
Issued on 17 June 2003
Valid from 15 August 2003

(29) Section 14, subsection 1, paragraph 1, of the Act sets out provisions on the obligation of the parent company of the conglomerate to disclose basic details of the member companies of conglomerates, including information on major owners and their holdings, as well as the names, domicile and nationalities of board members, the managing director and auditors. The disclosure requirement also applies to changes in such information. The parent company of the conglomerate must report this information to the FSA.

Binding
Issued on 17 June 2003
Valid from 15 August 2003

(30) The FSA will, at a later date, issue a standard setting out the contents of the report.

6

REPORTING TO THE FINANCIAL SUPERVISION AUTHORITY

Binding

*Issued on 17 June 2003
Valid from 15 August 2003*

(1) The notifications and reports to be filed with the FSA are more closely defined in section *Reporting* of the set of regulations.

Justifications

*Issued on 17 June 2003
Valid from 15 August 2003*

(2) The disclosure and reporting requirements of the conglomerate refer to:

- supervision of the owners of the holding company
- fitness and propriety of the management of the holding company
- auditor's qualifications and reporting requirements
- financial statements and consolidated financial statements
- intra-group transactions
- risk concentrations
- share and real estate holdings
- acquisition of control in an undertaking outside the European Economic Area
- disclosure of information on member companies

7

FURTHER DETAILS

A list of responsible persons, including contact details, is posted on the FSA's website. For further information, please contact

- Regulations of Financial Statements and Capital Adequacy Division, tel. +358 9 183 5398