

# **EXPLANATORY MEMORANDUM TO THE MERITS COMMITTEE OF THE HOUSE OF LORDS**

## **THE FINANCIAL CONGLOMERATES AND OTHER FINANCIAL GROUPS REGULATIONS 2004 No. 1862**

This explanatory memorandum is laid before Parliament by Command of Her Majesty.

HM Treasury is the Department responsible for the laying of this Instrument.

### **Description**

These Regulations implement, in part, Directive 2002/87/EC 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, 92/96/EEC, 93/6/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council ('The Financial Conglomerates Directive'). The Financial Conglomerates Directive will require the introduction (from financial years beginning in 2005) of additional prudential supervision of those groups that straddle the insurance and banking/investment business sectors significantly. The groups affected are called financial conglomerates. A group will be a financial conglomerate if at least 40% of its business is financial and at least 10% or Euro 6 billion of its financial business is in each of the combined banking/investment sectors.

The Financial Conglomerates Directive was incorporated into the EEA Agreement on the 9<sup>th</sup> July 2004 (by Joint Committee Decision 104/2004 of 9<sup>th</sup> July 2004).

The Financial Conglomerates Directive includes certain procedural requirements that competent authorities of EEA States must carry out. In the UK the Financial Services Authority (FSA) will act as the competent authority for these purposes. Thus these Regulations impose obligations on the FSA for the purpose of implementing the procedural requirements contained in the Financial Conglomerates Directive.

### **Legislative Background**

These Regulations are made to implement, in part, Directive 2002/87/EC 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, 92/96/EEC, 93/6/EEC, and Directives 98/78/EC and 2000/12/EC

of the European Parliament and of the Council ('The Financial Conglomerates Directive').

The UK is required to implement the Financial Conglomerates Directive before 11 August 2004 (see Article 32 of that Directive).

The FSA will implement the remaining part of the Directive in the UK.

The Transposition Table is attached with this document.

Financial Conglomerates Directive proposals cleared EU scrutiny in March 2002 following letters from the Economic Secretary to the Treasury to the House of Commons European Scrutiny Committee and to the Lords Select Committee on the European Union. The scrutiny document is referenced as '22392 Prudential Standards'.

### **Extent**

These Regulations apply to all of the UK.

### **European Convention on Human Rights**

Since these Regulations only impose procedural requirements on the FSA and do not have any human rights implications, the Financial Secretary to the Treasury, Ruth Kelly MP, is satisfied that these Regulations are compatible with Convention Rights.

### **Policy Background**

The financial services industry has continued to see the formation of cross-border financial groups with activities in the banking, investment and insurance sectors. This has prompted international regulators to consider how to contain and supervise risks arising in these groups. In the European Economic Area (EEA), this has resulted in the adoption of internationally agreed Principles by the Joint Forum on Financial Conglomerates. These principles are embodied in the Financial Conglomerates Directive.

Implementation of the Financial Conglomerates Directive should improve the supervision of financial groups operating in the EEA. It will introduce an enhanced prudential regime for the supervision of financial conglomerates - groups that straddle the banking/investment and insurance business sectors significantly. The Directive also amends existing European group prudential supervision requirements for insurance groups and banking and investment groups to close gaps in sectoral coverage.

Competent authorities responsible for the supervision of firms will play a significant role in the enhanced prudential regime. These Regulations will help ensure that the FSA, as the UK competent authority for the purpose of this Directive will follow the correct procedural requirements as required by the Directive.

A joint FSA/Treasury consultation document was published in October 2003. This consulted on the FSA's proposed rules and the Treasury's proposed Regulations to implement the Financial Conglomerates Directive in the UK. Twenty-nine responses were received in total from financial services firms. Two responses related directly to the Treasury's proposed Regulations.

The changes brought about by the Financial Conglomerates Directive are not of major political or legal significance. The Directive applies primarily to firms that are members of financial groups headed by a parent company in the EEA. It also requires equivalent group oversight of entities regulated in the EEA with a parent company outside the EEA.

### **Impact**

A Regulatory Impact Assessment has not been carried out on these Regulations. The Regulations impose obligations on the FSA and have no direct impact on the private or voluntary sector.

### **Contact**

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**HM TREASURY**

**19 JULY 2004**

## TRANSPOSITION TABLE

### FINANCIAL CONGLOMERATES DIRECTIVE

This table sets out how the main elements of Directive 2002/87/EC 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 Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council, will be transposed into UK law.

A reference to-

“ELM” is a reference to the Financial Services Authority’s (FSA) E-Money Sourcebook.

“ELMI” is a reference to an e-money issuer authorised by the FSA.

“FHC” is a reference to a financial holding company.

“FSMA” is a reference to the Financial Services and Markets Act 2000.

“the Glossary” is a reference to the Glossary to the FSA's Handbook of rules and guidance.

“IPRU(BANK)” is a reference to the FSA's Interim Prudential sourcebook for banks.

“IPRU(BSOC)” is a reference to the FSA's Interim Prudential sourcebook for building societies.

“IPRU(INS)” is a reference to the FSA’s Interim Prudential sourcebook for insurers.

“IPRU(INV)” is a reference to the FSA's Interim Prudential sourcebook for investment business.

“MAHC” is a reference to a mixed activity holding company.

“PRU” is a reference to the FSA's Integrated Prudential Sourcebook.

“PRU 8 Ann” is a reference to an annex to chapter 8 of the FSA's Integrated Prudential Sourcebook.

“the Regulations” are references to The Financial Conglomerates and Other Financial Groups Regulations 2004.

“SUP” is a reference to the FSA's Supervision Manual.

<b>Article</b>	<b>Paragraph</b>	<b>Implementation</b>
Article 1		No implementation required.
Article 2	Paragraph (1) Credit institution	In Glossary already.  Part 1, Regulation 1(2) of the Regulations – definition of “regulated entity”. Part 3, Regulation 7 of the Regulations Schedule 3, paragraph 5(b) of FSMA 2000.
	Paragraph (2) insurance undertaking	Glossary (definition of regulated insurance entity).  Part 1, Regulation 1(2) of the Regulations – definition of “regulated entity”. Part 3, Regulation 7 of the Regulations. Schedule 3, paragraph 5(d) of FSMA 2000.
	Paragraph (3) investment firm	In Glossary already.  Part 1 Regulation 1(4) of the Regulations – definition of “regulated entity”. Part 3, Regulation 7 of the Regulations. Schedule 3 paragraph 5(a) of FSMA 2000.
	Paragraph (4) regulated entity	New definition in Glossary.  Part 1, Regulation 1(2) of the Regulations.
	Paragraph (5) asset management company	New definition in Glossary.  Part 3, Regulation 7 of the Regulations.
	Paragraph (6) reinsurance undertaking	Expression not used in implementing measures.
	Paragraph (7) sectoral rules	New definition in Glossary.  Expression not used in the Regulations.
	Paragraph (8) financial sector	New definition in Glossary.  Expression not used in the Regulations.
	Paragraph (9) parent undertaking	Amended definition in Glossary.  Part XXIX Sect 420(1) and (2)(a) of FSMA 2000.

Article	Paragraph	Implementation
	Paragraph (10) subsidiary undertaking	Already in Glossary.  Part XXIX Sect 420 (1) and (2)(b) of FSMA 2000.
	Paragraph (11) participation	New definition in Glossary.  Expression not used in the Regulations.
	Paragraph (12) group	Definition of consolidation group in glossary.  Part XXIX Sect 421(1) of FSMA 2000.
	Paragraph (13) close links	Already in the Glossary.  Expression not used in the Regulations.
	Paragraph (14) financial conglomerate	New definition in PRU 8.4.5R and PRU 8 Ann 4R. Sub-groups dealt with in PRU 8.4.6R.  Part 1 Regulation 1(2) of the Regulations see also definition of third-country financial conglomerate in regulation 7(1).
	Paragraph (15) mixed financial holding company	New definition in Glossary.  Expression not used in the Regulations.
	Paragraph (16) competent authorities	Amended definition in Glossary.  Paragraph 1(2) of the Regulations. See also the definition of third-country competent authority in regulation 7(1) of the Regulations.
	Paragraph (17) relevant competent authorities	New definition in Glossary.  Part 1 Regulation 1(2) of the Regulations.
	Paragraph (18) intra-group transactions	New definition in Glossary.  Expression not used in the Regulations.
	Paragraph (19) risk concentration	New definition in Glossary.  Expression not used in the Regulations.
Article 3	Paragraph (1)	PRU 8.4.5R and PRU 8 Ann 4R.

<b>Article</b>	<b>Paragraph</b>	<b>Implementation</b>
	Paragraph (2)	PRU 8.4.5R and PRU 8 Ann 4R. Definition of smallest and most important financial sector in the Glossary. PRU 8.4.7R re combining the investment and banking sectors.
	Paragraph (3)	PRU 8.4.5R and PRU 8 Ann 4R.  Regulations 3 and 4 of the Regulations together with the existing powers referred to in those regulations.
	Paragraph (3) – Ability to relax or waive supervision if the group does not reach the threshold referred to in paragraph 2	Regulations 3 and 4 of the Regulations together with the existing powers referred to in those regulations.
	Paragraph (4)	Regulations 3, 4 and 15 of the Regulations together with the existing powers referred to in those regulations.
	Paragraph (5)	Regulations 3, 4 and 15 of the Regulations together with the existing powers referred to in those regulations.
	Paragraph (6) – First two paragraphs	PRU 8.4.9R- PRU 8.4.10R.
	Paragraph (6) – Last paragraph	Regulations 3, 4 and 15 of the Regulations together with the existing powers referred to in those regulations.
	Paragraph (7) (Balance sheet totals)	PRU 8.4.11R.
	Paragraph (7) (Solvency requirements)	PRU 8.4.12R
Article 4	Paragraph (1)	The duty to identify flows from the rules that have been implemented by the FSA.
	Paragraph (2)	Regulation 2(1) and 2(4) of the Regulations.

<b>Article</b>	<b>Paragraph</b>	<b>Implementation</b>
Article 5	Paragraph (1)	This paragraph contains a general duty on a competent authority to supervise. No specific implementation is required as the duty to supervise flows from the fact that the FSA has made rules on the matters covered by this paragraph, particularly from the duty on the FSA under paragraph 6 of Schedule 1 FSMA 2000.
	Paragraph (2) – First Paragraph	PRU 8.4.1R. Definition of third country financial conglomerate and EEA financial conglomerate.
	Paragraph (2) – Second Paragraph	PRU 8.4.28R.
	Paragraph (3)	See commentary on Article 18. See definition of third country financial conglomerate and EEA financial conglomerate.
	Paragraph (4)	Regulations 3, 4 and 15 of the Regulations together with the existing powers referred to in those regulations.
	Paragraph (5)	No obligation imposed.
Article 6	Paragraph (1)	See comments on the implementation of paragraph 1 of Article 5.
	Paragraph (2) – First paragraph	See commentary on the implementation of Annex I of the Conglomerates Directive.
	Paragraph (2) – Second paragraph	PRU 8.1.12R(2).
	Paragraph (2) – Third paragraph	See comments on the implementation of paragraph 1 of Article 5.
	Paragraph (2) – Fourth and fifth paragraphs	SUP 16.7.73-74.
	Paragraph (3)	The entities referred to here are set out in the definition of the financial sectors. PRU 8 Annex 1 paragraph 5.4 says that for all Methods the scope of application extends to every member of the overall financial sector, including the mixed financial holding company.



<b>Article</b>	<b>Paragraph</b>	<b>Implementation</b>
	Paragraph (4)	See commentary on the implementation of Annex I of the Conglomerates Directive.
	Paragraph (5) (except for last paragraph)	Regulations 3, 4 and 15 of the Regulations together with the existing powers referred to in those regulations.
	Paragraph (5) (last paragraph)	Part XI of FSMA.
Article 7	Paragraph (1)	See comments on the implementation of paragraph 1 of Article 5.
	Paragraph (2) – First paragraph	SUP 16.7.73-74.
	Paragraph (2) – Second paragraph	See comments on the implementation of paragraph 1 of Article 5.
	Paragraph (3)	Option not adopted.
	Paragraph (4)	PRU 8.4.35R.
Article 8	Paragraphs (1) and (2)	SUP 16.7.73-74. See comments on the implementation of paragraph 1 of Article 5.
	Paragraph (3)	Option not adopted.
	Paragraph (4)	PRU 8.4.35R.
Article 9	Paragraph (1)	PRU 8.1.9R.
	Paragraph (2)	PRU 8.1.12R.
	Paragraph (3)	PRU 8.1.13R
	Paragraph (4)	PRU 8.1.11R.
	Paragraph (5)	See comments on the implementation of paragraph 1 of Article 5.
Article 10	Competent authority responsible for exercising supplementary supervision (the coordinator) Art 10 (3)	Regulation 2(2) & (3) of the Regulations.

Article	Paragraph	Implementation
Article 11	Tasks of the coordinator	Regulation 12 of the Regulations and FSMA.
Article 12	Cooperation and exchange of information between competent authorities	<p>Amendments to the Financial Services and Markets Act 2000 (Consultation with Competent Authorities) Regulations 2001 (S.I. 2001/2509) by Regulation 13 of the Regulations.</p> <p>As regards the exchange of information see Part 4 of the Regulations.</p> <p>As regards consolidation in the case of major sanctions or exceptional measures regulation 5 of the Regulations.</p>
Article 13		In the case of an unauthorised holding company, this is dealt with by the FSA's existing powers in the FSMA, in particular by the powers in Part V (Performance of regulated activities), the powers in Part XII (Control over authorised persons) and the indirect powers that the FSA has over holding companies by virtue of its powers over subsidiaries of the holding company authorised under FSMA (including the application of Schedule 6 (Threshold Conditions)). If the holding company is authorised under FSMA, implementation of this Article is dealt with by the FSA's existing powers over authorised firms, particularly Part V of FSMA and its powers in relation to the threshold conditions.
Article 14		FSMA 2000, Sect 165.
Article 15		FSMA 2000, Part XI with section 169 (7).
Article 16		Enforcement provisions in FSMA 2000 Part XIV.
Article 17		FSMA 2000, together with the Regulations especially regulation 15.
Article 18		<p>PRU 8.5 and PRU 8 Ann 2 cover Article 18(2).</p> <p>Regulations 8 and 15 of the Regulations.</p>
Article 19		No implementation required.
Article 20		No implementation required.
Article 21		No implementation required.

<b>Article</b>	<b>Paragraph</b>	<b>Implementation</b>
Article 22	Paragraph (1)	Sect 49 FSMA 2000 plus if necessary a direction under section 410(2) of FSMA 2000.
	Paragraph (2)	Amendments to IPRU(INS) rule 4.2.
Article 23	Paragraph (1)	See Sect 49 FSMA 2000 plus if necessary a direction under section 410(2) of FSMA 2000.
	Paragraph (2)	Amendments to IPRU(INS) rule 4.2.
Articles 24 and 25	Paragraph 1	Amendments to the Financial Services and Markets Act 2000 (Consultation with Competent Authorities) Regulations 2001 (S.I. 2001/2509) by Regulation 13 of the Regulations.
	Paragraph 2	Part 4 of the Regulations and FSMA 2000 (Disclosure of Confidential Information) Regulations 2001.
Article 26		New chapter 14 for IPRU(INV).
Article 27		Sect 49 FSMA 2000 plus if necessary a direction under section 410(2) of FSMA 2000.
Article 28	Paragraph (1)	Amendments to the definitions of IPRU(INS).
	Paragraph (2)	No obligation imposed.
	Paragraph (3)	PRU 8.1.9 and amendments to IPRU(INS).
	Paragraph (4) (cooperation)	No obligation imposed.
	Paragraph (4) (holding companies)	See comments on Article 13.

Article	Paragraph	Implementation
	Paragraph (5)	Regulation 15 of the Regulations. Amendments to IPRU(INS).
	Paragraph (6)	Amendments to the definitions of IPRU(INS).
Article 29 (for banks)	Paragraph (1) (participation)	For the purpose of supervision on a consolidated basis and for the purpose of insurance deductions, Section 3 of Chapter GN of IPRU(BANK).
	Paragraph (1) (financial holding company)	Section 3 of Chapter GN of IPRU(BANK).
	Paragraph (1) (mixed-activity holding company)	Section 3 of chapter GN.
	Paragraph (2)	Sect 49 FSMA 2000 plus if necessary a direction under section 410(2) of FSMA 2000.
	Paragraph (3)	Amendments to the Financial Services and Markets Act 2000 (Consultation with Competent Authorities) Regulations 2001 (S.I. 2001/2509) by Regulation 13 of the Regulations.
	Paragraph (4)	Section 10.2 of Chapter CA of IPRU(BANK).
	Paragraph (5)	Section 10.4 of Chapter CA of IPRU(BANK).
	Paragraph (6)	No obligation imposed. However, see Section 2 of Chapter CS of IPRU(BANK).
	Paragraph (7)	Regulation 15 of the Regulations. See section 4.3 of Chapter CS of IPRU(BANK).
	Paragraph (8)	See comments on Article 13.

<b>Article</b>	<b>Paragraph</b>	<b>Implementation</b>
	Paragraph (9) (general supervision)	See comments on the implementation of paragraph 1 of Article 5. However there is material on this in Section 3.1.4 of Chapter CS of IPRU(BANK).  Regulation 15 of the Regulations.
	Paragraph (9) (adequate controls)	PRU 8.1.14R.
	Paragraph (9) (reporting)	SUP 16.7.8.
	Paragraph (9) (taking measures)	See comments on the implementation of Article 16.
	Paragraph (10)	FSMA 2000 Part XI with 169(7).
	Paragraph (11)	See commentary on Article 18. A cross-reference can be found in section 4 of chapter CS of IPRU(BANK).  Regulations 9, 10 and 15 of the Regulations.
Article 29 (for building societies)	Paragraph (1) (participation)	For both the purpose of supervision on a consolidated basis and for the purpose of insurance deductions, see Annex 1D of Chapter 1 of IPRU(BSOC) Volume 1.
	Paragraph (1) (financial holding company)	Not implemented because a building society cannot have a FHC.
	Paragraph (1) (mixed-activity holding company)	Not implemented as a building society cannot have a MAHC.
	Paragraph (2)	As for banks.
	Paragraph (3)	As for banks.
	Paragraph (4)	Section 1.8 of Chapter 1 of IPRU(BSOC) Volume 1.
	Paragraph (5)	Section 1.16 of Chapter 1 of IPRU(BSOC), Volume 1.
	Paragraph (6)	Inapplicable as a building society cannot have a financial holding company.

Article	Paragraph	Implementation
	Paragraph (7)	Inapplicable as the relationship mentioned in 7(a) cannot exist for a building society.
	Paragraph (8)	Inapplicable as a building society cannot have an FHC.
	Paragraph (9)	Inapplicable as a building society cannot have a MAHC.
	Paragraph (10)	FSMA 2000 Part XI with 169(7).
	Paragraph (11)	Inapplicable as a building society cannot have a third country parent.
Article 29 (for ELMIs)	Paragraph (1) (participation)	Definition in Glossary.
	Paragraph (1) (financial holding company)	Amended definition in Glossary.
	Paragraph (1) (mixed-activity holding company)	Glossary.
	Paragraph (2)	As for banks.
	Paragraph (3)	As for banks.
	Paragraph (4) (insurance)	Amendment to ELM 2.4.17R.
	Paragraph (4) (banking and investment)	ELM 2.4.17R .
	Paragraph (5)	Article 51 of the Banking Consolidation Directive does not apply to ELMIs (see Article 2(2) of the E-Money Directive).
	Paragraph (6)	No obligation imposed.
	Paragraph (7)	Regulation 15 of the Regulations. See ELM 7.8.9G.
	Paragraph (8)	As for banks.
	Paragraph (9) (general supervision)	As for banks.
	Paragraph (9) (adequate controls)	As for banks.
	Paragraph (9) (reporting)	SUP 16.7.66.

Article	Paragraph	Implementation
	Paragraph (9) (taking measures)	As for banks.
	Paragraph (10)	FSMA 2000 Part XI with 169(7).
	Paragraph (11)	As for banks (except for the material in IPRU(BANK)).
Article 29 (for investment firms)	Paragraph (1) (participation)	For the purpose of supervision on a consolidated basis, see the Glossary for chapter 14 of IPRU(INV). For the purpose of insurance deductions, see the following: amendments to IPRU(INV) Tables 5.2.2(1), 7.3.1R, 10-62.2A, 10-62.2B, 10-62.2C, 13.5.4(1) and 13.5.4(2) – also amendments to the Glossary at IPRU(INV) 10.
	Paragraph (1) (financial holding company)	See the Glossary for chapter 14 of IPRU(INV).
	Paragraph (1) (mixed-activity holding company)	Glossary.
	Paragraph (2)	As for banks.
	Paragraph (3)	As for banks.
	Paragraph (4) (insurance)	See the following amended rules in IPRU(INV): Table 10-62(2)A, table 10-62(2)B and table 10-62(2)C. Amendment to illiquid assets deductions in chapters 5 and 13.
	Paragraph 4 (banking and investment holdings)	Already implemented in the existing rules. See IPRU(INV) Table 5.2.2(1)R, Tables 10.62(2)(A)-(C), Table 13.3.2(1), 14.4.2(3).
	Paragraph (5)	Not applicable.
	Paragraph (6)	As for banks.
	Paragraph (7)	Regulation 15 of the Regulations. See paragraph 14.2.4(3) of chapter 14 of IPRU(INV).
	Paragraph (8)	As for banks.
	Paragraph (9) (general supervision)	As for banks.

Article	Paragraph	Implementation
	Paragraph (9) (adequate controls)	As for banks.
	Paragraph (9) (reporting)	SUP 16.7.25, SUP 16.7.27, SUP 16.7.36 and SUP 16.7.47.
	Paragraph (9) (taking measures)	As for banks.
	Paragraph (10)	FSMA 2000 Part XI with 169(7).
	Paragraph (11)	As for banks.
Article 30	Inclusion in scope of sectoral consolidation	Included in all sectors in the sectoral rules. For the investment services sector, see rule 14.2.2 in chapter 14 of IPRU(INV). For IPRU(BANK), see Chapter CS 4.3.3(e). For IPRU(BSOC), see definition of 'financial institution in Annex 1D and 1.13.1G of Chapter 1 of Volume 1. For ELM, see revised definition of financial institution in the Glossary. For IPRU(INS), see rule 4.2 and definition of 'asset management company'.  Regulation 7, 9(5) and 10(6) of the Regulations.
	Inclusion in the supervision of financial conglomerates	PRU 8.4.39R.
	Treating them as regulated entities under supervision of financial conglomerates	PRU 8.4.39R.  Regulations 7 and 8 of the Regulations.
	Treating them as regulated entities under supervision of sectoral groups.	See the first box on Article 30.  Regulation 7, 9(5) and 10(6) of the Regulations.
Article 31		No obligation for Member States.
Article 32		Commencement provisions are to be included in the cover sheets of the implementing instruments. Regulation 1 of the Regulations.
Article 33		No obligation for Member States.



Article	Paragraph	Implementation
Annex I		<p>PRU 8 Ann 1 and PRU 8.4.26R-PRU 8.4.31R.</p> <p>Regulations 3, 4 and 15 of the Regulations together with the existing powers referred to in those regulations.</p>
Annex II		<p>See commentary on Articles 7 and 8.</p> <p>Regulations 3, 4 and 15 of the Regulations together with the existing powers referred to in those regulations.</p>