Position Paper

Response to European Commission consultation on the evaluation of the financial conglomerate directive (FICOD)

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Contact person:	Carolien Afslag, policy advisor, prudential regulation	E-mail:	afslag@insuranceeurope.eu
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Summary

Insurance Europe believes that the purpose of the FICOD should be to ensure there are no gaps between sectorial legislation and to avoid duplication and overlap with sectorial regulation, including guidelines issued by ESA's. Currently this is not being fully achieved, in part because FICOD was designed and written before the latest sectorial legislation was put into effect (e.g. Solvency II and CRD4). Therefore, a review and refinement of FICOD is needed.

Insurance Europe has provided detailed answers to most questions below but our key general comments are:

- FICOD was implemented before Solvency II was in place and it represented significant improvements over SI which was an entity level rather than group level directive. Solvency II has been designed to apply at both entity level and group level. Solvency II requires that the ultimate parent is identified including whether this would be an insurance or reinsurance undertaking, insurance holding company or mixed financial holding company and sets group level most, if not all of FICOD's risk management and reporting requirements at that level. Therefore, FICOD should be updated to recognise Solvency II and avoid duplication of requirements already covered under Solvency II.

- Due to lack of clarity on definitions and scope and/or supervisory discretion, currently insurance groups can be required to apply Solvency II, CRD4 and FICOD. This leads to significant unnecessary expense and effort and avoiding this should be a key aim of any changes to FICOD. Solvency II reporting should be the only group level requirement for insurance dominated financial conglomerates (hereafter "insurance groups").

- Having a single supervisor act as a coordinator with a clear role should be an aim of any FICOD review. For example, all requests for group level information should be via this coordinator.

Insurance Europe aisbl
Rue Montoyer 51, B-1000 Brussels
Tel: +32 2 894 30 00 • Fax: +32 2 894 30 01
E-mail : info@insuranceeurope.eu
www.insuranceeurope.eu

Questions on activities and entities

1(a) How successful has FICOD been in identifying the right entities and activities to fall within the scope of the Directive? Has there been any lack of legal clarity and/or predictability about what entities and activities fall within the scope of FICOD affected, and if so, has that had any impact on: (i) risks to financial stability; (ii) the level playing field; and (iii) the level of protection of creditors and policyholders.

Answer:
The FICOD has some deficiencies in identifying the right entities and group. There should be a clear and complete definition of the entities that fall within the scope of a financial conglomerate aligned with the definitions of the banking and insurance legislation for entities within a group (EU-regulation 575/2013, Directive 2009/138/EC). The purpose of FICOD should be that there is no duplication with regard to Solvency II requirements, and that an insurance led group does not have to apply anything else than Solvency II at ultimate parent level.

1(b) To what extent is FICOD clear on which entities qualify as mixed financial holding companies, including in situations where there is a chain of holding companies making up several subgroups with a large complex group?

Answer:
There are three issues that illustrate that the **FICOD is not entirely clear regarding on which entities qualify as MFCH, and that current requirements create unintended consequences**.

The first issue relates to situations whereby conglomerate supervision might be exercised at different levels in the conglomerate. Some member states are using the option of Article 5(2) of the FICOD, whereby FICOD supervision is, in principle, only exercised at the level of the ultimate parent of the MFCH in the group. **It should be made clear that there should be no need to capture a view at the level of the sectoral parent when the view is captured at the level of the mixed financial holding company (MFHC)**. It may be advisable to further limit the possibilities to exercise conglomerate supervision at intermediate holding levels.

The second issue relates to the identification of the ultimate parent under FICOD:

- The current definitions in FICOD do not always allow for the identification of the right ultimate parent.
    - For example, a minority shareholder can be recognized as the ultimate parent under FICOD if the group qualifies as a financial conglomerate. If the minority shareholder holds more than 20% and as such qualifies as the ultimate parent of a financial conglomerate, the entity in which the minority shareholder has an interest is then deemed to be a sub-financial conglomerate.
    - This causes all kind of problems in retrieving and submitting information. Indeed, financial conglomerates cannot easily distribute additional information to the minority shareholder because they have to provide all shareholders with the same information. Hence, the minority shareholder, even with an interest of more than 20%, cannot compel the FICO to provide the information requested by the FICOD.
- The FICOD should be clear in defining which entity is the ultimate parent and Insurance Europe suggests considering using the notion of "control" as the only criterion to establish the "ultimate parent" and thus the entity required to submit the information to the group supervisor.

The third issue relates to the working of the CRD IV/CRR, Solvency II and FICOD in conjunction. Financial Conglomerates can be subject to multiple sectoral legislation for group supervision. There are pieces of legislation within FICOD, CRD, and Solvency II that allow supervisors to "waive" multiple group supervision. However, this is not always used. In our view the insurance dominated financial conglomerate should be

subject to Solvency II legislation for the group/conglomerate solvency calculations. Along the same lines, banking led financial conglomerates should be subject to CRD IV / CRR legislation for the group/conglomerate solvency calculations. And for mixed financial conglomerates, a joint decision should be made regarding the most appropriate legislation to be used for the group/conglomerate solvency calculations. In all these cases, the sectoral rules will apply to the entities within each sector as they are developed for them.

Having multiple non-harmonized prudential regimes will make it impossible to manage the financial conglomerate and will seriously impede the competitiveness.

Financial conglomerates, in the meaning of the FICOD, headed by a mixed financial holding company (MFHC), are formally subject to consolidated CRR supervision (Article 11(3) CRR). The CRR uses the concept of MFHC from the FICOD in the context of CRR consolidated supervision.

However, unlike the FICOD itself, the CRR does not distinguish between conglomerates with a primary banking (including asset management) character, conglomerates with a primary insurance character and conglomerates with a (more or less) even division of banking and insurance activities.

The application of CRR consolidated supervision to MFHCs with a primary insurance character (i.e. large insurance groups with a relatively small bank in the group) has unintended consequences. Such groups, which are treated primarily as insurance groups and, as such, are subject to Solvency II group supervision, would become, according to Article 11(2) and Article 11(3) of the CRR, subject to the obligations of Part II, III, IV, VI and VII of the CRR on the basis of the consolidated situation of the parent MFHC. This means these groups would need to comply, on a consolidated basis, with capital requirements, own fund requirements, large exposure requirements, liquidity requirements and leverage requirements on a consolidated basis, in addition to the comprehensive Solvency II group requirements.

These groups are managed primarily as insurance groups, not as banking groups. The requirements imposed by Solvency II are developed for such groups and these groups should, on a group basis, be regulated in accordance with these requirements (in addition to the solo-requirements to which the banking part of the group is subject). The differences that exist between Solvency II and CRR lead to unsatisfactory results. For instance, the calculation of the CRR consolidated own funds for such groups may lead (depending on the capital structure of the group and the calculation method applied) to a significantly overstated or understated consolidated capital position. In neither case (either a full deduction of the insurance entities or a 100% risk-weighting of these entities), the result of the calculation reflects the actual capital position of the insurance conglomerate properly, on a consolidated basis.

With respect to the other CRR requirements referred to, other complications arise, due to the fact that the CRR requirements are tailored to banking groups and banking activities, not to insurance groups with a relatively small bank in the group.

Similar to the CRR, in the Bank Recovery and Resolution Directive, the MFHC concept is also used, with respect to application of the BRRD requirements at consolidated level (see article 1(1) c of the BBRD). This means that the BRRD requirements, which have been designed for the recovery and resolution of banks and banking groups, would formally also apply to insurance led conglomerates. BRRD requirements, generally speaking, are not designed for such groups. Insurance groups, not being a financial conglomerate (or insurance led conglomerates not headed by an MFHC) are not subject to the BRRD requirements.

Therefore, Insurance Europe suggest that:
The concept of Mixed Financial Holding Company is not used in (essentially) sectoral (banking) directives and regulations, such as the CRR/CRD IV and BRRD as it creates unnecessary burdens on those insurance conglomerates that includes banking activity due to lack of harmonisation. The CRD IV/CRR should rather make reference to Article 2(15 of FICOD) like the Solvency II Directive does in Article 213(1)(h)

An alternative to the application of CRD IV as referred to above may be for the banking parts to keep the insurance own funds and add the related capital requirements, as indicated in the Article 49(1) of the CRD IV and the recently issued [ECB consultation](), meaning that:

The Solvency II Directive requires a group to include the information of the banking sector based on the sectoral requirements in the Solvency position. This enables the group supervisor to assess the solvency position of the whole group based on the fundamental drivers of the risks faced by each sector.

The same requirement could be included in the CRD IV Directive. Thus not subtracting the whole investments in the other financial sector or (as proposed by the ECB) the determined capital requirement of the other financial sector, but to use the sectorial requirements in the consolidated data.

2(a) Mixed financial holding companies, financial holding companies and insurance holding companies fall within the scope of FICOD and in particular a capital requirement is imposed at that level of the group. However, supervisory authorities may not have direct powers of supervision over those holding companies such that they can require those holding companies to change their capital structure. Has this had any impact on the effectiveness of FICOD in identifying and managing group risk?

Answer:
No. The fact that supervisors may not have direct powers has no negative impact on the effectiveness of FICOD.

- From a regulatory point of view, the sectoral frameworks provide for enough powers that can be exercised at the ultimate parent level e.g. the holding.

  - Both Solvency II and CRD IV/CRR Directives do extend the powers to the supervisors. The group supervisor under Solvency II has the power to ask for changes in capital structures if they are not meeting the requirements as put forward in the relevant sectoral requirements.
  - A banking-led conglomerate will be governed by the biggest CRD-supervised entity in the group. They will have to ensure the full compliance with the CRD IV/CRR.

- From a business point of view,
  - Typically, the risk of a holding company is the risk of investing in subsidiaries and affiliates. From a group perspective, this investment risk is replaced by the risks of the operating companies of the group which are usually credit institutions, insurance undertakings and investment firms. These entities are regulated entities on a solo and/or sectoral level. The supervisory authorities have the power to influence the capital structure of the regulated entities and sectors, so indirectly they already have the possibility to influence the capital structure of the group.
  - A financial conglomerate will have an effective Enterprise Risk management at the group level.

However, Insurance Europe believes that FICOD should not lead to additional burdens for the regulated entities and that supplementary supervision should build on existing sectorial requirements to the extent possible, although Insurance Europe welcomes the idea to foster a more harmonized approach with respect to supervisory measures at financial conglomerate level. In our view the supervision of a conglomerate should be done according to the sectorial legislation of the dominant sector. An insurance-led conglomerate should first be governed by the Solvency II legislation for the solvency calculations at the level of the group/conglomerate, whereas the sectoral rules apply to the entities within each sector as they are developed for them.

2(b) Other unregulated, non-financial entities (and their activities) that are relevant to the risk profile of the financial conglomerate are not included within the scope of supplementary

supervision - for instance mixed activity holding companies are excluded. Has this had any impact on the effectiveness of FICOD as a tool to identify and manage group risk?

Answer:
No. such entities are covered in Solvency II group supervision. Effective identification and management of such risks is accomplished in the sectoral Solvency II framework, which also includes cross-sectoral risks. In our view, FICOD does not have added value in this respect.

2(c) What would be the costs involved in including such entities and activities, including legal and operational?

Answer:
For insurance groups already subject to Solvency II, any costs involved would therefore be unnecessary since this is covered in the Solvency II framework and would result in duplicative requirements.

Questions on thresholds and waivers

3. To what extent are the quantitative threshold rules in FICOD:
(a) clear and effective (in terms of, for example: drafting, parameters used to calculate them e.g., assets and capital requirements, accounting treatment of assets across various sectors, are indicators that apply to all relevant sectors in a financial conglomerate equivalent, do all financial institutions that are part of a banking group have solvency requirements);
(b) predictable for the industry; and
(c) create costs either for supervisors or entities? Are any of the costs unnecessary?
(d) is the application of the thresholds transparent?

Answer:
The quantitative thresholds are clear and easy to implement. However, improvements can be made in relation to clarifying the scope and purpose of supervisory discretion and in how thresholds are calibrated:

- The circumstances in which discretion is applied in accordance with Article 3(3) and Article 3(3a) of FICOD are not clear. It would be useful to understand if and how this discretion is used by supervisory authorities.
- The thresholds in Article 3 of FICOD do not take into account differences of the markets. The current calibration based on the total European financial market is not adequate for all conglomerates. The thresholds should be linked to the size of the market in which the conglomerate is operating. For conglomerates that focus their activities to one or a few countries, the level of the thresholds could be lower
- Specifically regarding the threshold set out in Article 3(3) of FICOD, it is not entirely clear whether cross-sectoral activities" are supposed to measure the external business volume in each sector, or the interconnectedness between the insurance and banking sector of the conglomerate. In case it is the latter, Insurance Europe wonders to what extent a balance sheet total does accurately capture "cross sectoral activities". Instead, Insurance Europe believes that intra-group transactions and positions between the various identified financial sectors are a better reflection of these "cross sectoral activities".

4. Considering the quantitative threshold rules in FICOD, has the effectiveness of FICOD in identifying and managing group risks been affected to any extent by the fact that thresholds are not risk based?

Answer:
No comments

5. To what extent do you consider that the current quantitative thresholds have provided a bias for or against the inclusion of certain types of groups?

Answer:
The thresholds are not risk-based/return-based which provide a bias in the evaluation of MFCHs from an economical point of view and somehow contradicts the goals of the sectoral rules (e.g. Solvency II and CRD IV/CRR Directives). Moreover, any different form of group structures could be overlooked e.g. where not the legal substance but the economic substance of the arrangements is important.

6. To what extent has current national discretion to use waivers impacted: (i) financial stability; and (ii) the level playing field, both within Europe and internationally?

Answer:
No comments.

Questions on capital adequacy

7. Are the rules in FICOD (including Annex 1) clear as to what capital adequacy at the level of the conglomerates means and what calculations are required from a financial conglomerate? Are the relevant entities included for the purpose of calculating the capital adequacy requirements?

Answer:
Yes. The different principles of the sectors complicate the calculation. The capital calculation of the insurance sector regime is based on market values, whereas the banking regulation is based on accounting rules (IFRS, local GAAP). The calculation of capital requirements also differs significantly. According to consolidation method 1, the group view is based on the consolidated accounts. Consequently, the market values of the regulatory regime for the insurance sector do not correspond with the consolidated accounting values. Insurance Europe believes that it is necessary to use sectoral rules both for capital and capital requirement, but more detailed explanation on how the aggregation of the sectors should be executed would be helpful.

Additionally, it should be noted that the scope of entities included in the calculation should be aligned with the definitions of the sectoral regimes (575/2013 "CRR"; 2009/138/EC "Solvency II"). In the current version of the FICOD there is still a reference to former directives (2000/12/EG, 98/78/EG and 93/6/EWG). An editorial update of the FICOD is required.

8(a) What is the added value of the FICOD capital adequacy calculation, taking into consideration that each financial sector in the financial conglomerate is subject to capital adequacy rules at the sectoral level?

Answer:
For insurance-led conglomerates, there is no added value because all of the important aims and requirements of FICOD have been included in Solvency II's group capital requirements.

- An insurance-led conglomerate should first be governed by the Solvency II legislation. Article 213 of Solvency II requires creating an insurance group.

- There is one consolidated balance sheet at group level. The banking activities are integrated taking into account the proportional share of the undertakings' own funds calculated according to the relevant sectorial rules.

- The capital requirements are also added according to the sectorial legislation. Pillar II (group ORSA) requires an assessment of intra-group transactions, contagion and other group risks, etc. This should be enough in order to avoid that from a CRD/CRR perspective a similar assessment is required.

- Solvency II does not permit double gearing and ensures that all adjustments/eliminations are done at the (re)insurance group level.

After all, for insurance led conglomerates there is hardly any justification to maintain costly and duplicative capital adequacy calculations. Moreover, even marginal and immaterial differences between the capital ratios of the group and the conglomerate would need to be explained to the markets without providing substantial insight except technical particularities.

8(b) What are the costs for financial conglomerates and / or supervisors related to capital adequacy calculations? Do they entail any unjustified additional burden on financial conglomerates or supervisors?

Answer:
Yes, for example:

- Solvency II capital adequacy calculations take into account all risks that Solvency II groups face, the elements that are covered by the FICOD calculations are duplicative.

- There are two types of unnecessary burden caused:
  - Firstly, where FICOD requires reporting similar but not identical to Solvency II reporting
  - Secondly, where, as indicated earlier, some insurance groups have to meet the group requirements for three directives (CRD IV/CRR, Solvency II and FICOD). This is particularly expensive and some cases very difficult given the different definitions used across these legislations. Insurance Europe notes that there are articles in the current legislation such as article 120 of the CRD IV (similar articles exist within FICOD and Solvency II) which could provide waivers for additional group supervision but these are subject to supervisory approval and not used by all supervisors.

8(c) How does the regulatory technical standards on capital interact with sectoral legislation? Does the interaction between FICOD capital adequacy requirements and the relevant sectoral legislation; (i) ever result in the requirements of one financial sector being applied to entities belonging to another financial sector; and (ii) lead to difficulties regarding earnings distribution at sectoral level and / or conglomerate level?

Answer:
Yes, there are some cases where FICOD results in the application of bank rules to insurance business.

- For example, regarding risk concentration, the requirements for banks are applied to the insurance sector entities in bank-led conglomerates, whereas the insurance sector has its own rules for concentration risk. The application of banking rules is not adequate for the insurance business.

Insurance Europe believes it is necessary that FICOD clarifies interactions between the banking, the insurance and the financial conglomerates related regulations in order to avoid the duplication of requirements that adds complexity to group operations and creates unduly increased costs to comply with excessive regulations.

Moreover, Insurance Europe would like to note that there is a potential for difficulties, because of cross-references in Solvency II to FICOD accounting methods.

- Solvency II refers on various places to methods 1 and 2 of the FICOD, instead of the accounting consolidation and deduction and aggregation method of Solvency II itself. Insurance Europe believes any potential difficulties could be avoided if Solvency II referred to Solvency II concepts only.

- From a practical point of view, the cross-references in the Solvency II to FICOD (and in CRD IV/CRR and BRRD to FICOD definitions, such as the mixed financial holding company definitions) means that companies are obliged to monitor multiple regulatory frameworks, because changes in the FICOD framework could impact the Solvency II framework and the use of FICOD definitions in other frameworks such as CRD IV and BRRD means that these banking oriented frameworks become applicable to all conglomerates, including insurance-led conglomerates.

9. FICOD does not contain any explicit provisions allowing supervisors the discretion to require additional capital to be held against specific cross-sector risks in the financial conglomerate. Has this had any impact on the supervisory effectiveness of FICOD?

Answer:
Insurance Europe is not aware of such impacts. The fact that authorities have the possibility to require additional capital at the sectoral level helps preventing such impacts.

10. To what extent did the regulatory standard on capital clarify the application of the methods set out in Annex 1 of FICOD?

Answer:
The regulatory technical standard was helpful to set up a consolidated calculation of the capital adequacy, but still there are some issues for further clarification as explained in our response to question 7.
Furthermore, Article 16 Commission Delegated Regulation (EU) No 342/2014 should be rephrased to clarify that a combination of methods is not an own distinct method.

11. The regulatory technical standards on capital made it clear that under certain circumstances some types of surplus capital in the sectoral parts can be transferred to the level of financial conglomerate. What impact has this had on risks that relate to intra-group loss covering?

Answer:
Insurance Europe considers the transfer of surplus capital as an important instrument to manage the capital distribution between the sectors properly. Unintended consequences arising from the transfer of surplus capital from one sector to another should be monitored carefully.

Questions on corporate governance and risk management processes

12(a) Have the FICOD rules on governance, risk management (including capital management) and internal controls contributed to sound governance in financial conglomerates and has there been an impact on the organisation of conglomerates?

Answer:
FICOD was implemented before Solvency II was in place and believe that it helped the general move within the insurance industry towards enhancing group as well as entity level risk management and group audit departments and in particular the move towards an integrated approach. However, as noted in answer to

earlier questions, Solvency II now covers all group risk requirements in a comprehensive way and so FICOD should now be adjusted to rely on Solvency II and so avoid overlaps and duplication.

12(b) To what extent have the FICOD rules on governance, risk management and internal controls have added value compared to the sectoral rules?

Answer:
For insurance groups under Solvency II, there is no added value. However, compared to SI requirements the value was significant.

13. To what extent, if any, does the absence of an EU wide resolution framework for financial conglomerates impact the effectiveness of FICOD?

Answer:
In our opinion, resolution frameworks should be kept at the sectoral level and work is underway to develop resolution frameworks at these levels. Care must be taken to avoid unnecessary duplications and costs.

Questions on risk concentrations and intra-group transactions

14. To what extent, if any, have the rules in FICOD on intra-group transactions and risk concentrations that empower supervisors to monitor intra-group transaction and risk concentration enhanced the supervision of financial conglomerates, taking into consideration that each sector is subject to its respective sectoral legislation?

Answer:

Relative to SI these powers, FICOD introduced significant new monitoring however, compared to Solvency II Insurance Europe does not see the need for FICOD to require anything additional.

Referring to the waiver provided for in 2011/89/EU which foresees: if sectoral legislation sufficiently covers supervision of intra-group transactions (IGTs) and risk concentrations (RCs) for financial conglomerate supervisory purposes, then requirements on IGTs and RCs may be carried out only once. Insurance Europe fully believes that Solvency II is sufficiently robust to make use of this waiver.
Moreover, reporting of risk concentration and intra-group transactions should be aligned to the greatest extent possible with existing sectorial requirements, e.g. the Solvency II reporting (QRTs) at least in terms of scope, content, frequency, and channel of communication. Moreover, both the definition of risk concentrations and intra-group transactions and the supervisory measures should defer to sectorial requirements to the largest possible extent.

FICOD authorizes member states and respectively NCAs to set quantitative limits on risk concentrations within a FICO. Some NCAs have imposed the limits and calculation methods of banking legislation to the whole conglomerate which is not appropriate in our opinion. The insurance sector has its suitable legislation for concentration risk an investment rules. This double supervision by inappropriate provisions should be amended.

Regarding the rules on intra-group transactions, Insurance Europe thinks they are an effective instrument to get a better understanding of the extent of the interconnectedness of the sectors and the capital relations in the group.

15. To what extent, if any, do you observe a difference in the treatment of banking-led and insurance-led conglomerates with respect to risk concentrations and intra-group transactions?

Answer:
See responses to question 14.

16. To what extent, if any, have the regulatory technical standards on intra-group transactions and risk concentrations been effective in coordinating supervision of intra-group transactions and risk concentrations?

Answer:
See responses to question 14.

Questions on risk management in differing structures

17. To what extent has FICOD provided supervisors or Member States with tools and powers to address the risks which may stem from the new structures mentioned above?

Answer:
No comments.

Questions on supervisory cooperation

18. To what extent is FICOD clear on how to identify the coordinator?

Answer:
Article 10 of FICOD is clear on the process for appointment of the coordinator. Insurance Europe strongly supports that there should be a supervisor who should act as a single point of contact for the conglomerate. However, the role of the coordinator is not clear enough. This leads to problems where there are multiple layers of supervision and it can be unclear who would have ultimate decision making powers and there is currently risk of duplicating tasks. Insurance Europe recommends for example, that only the coordinator is entitled to ask the information from the head of the conglomerate.

19. To what extent does the identification of a subset of relevant competent authorities out of a group of competent authorities benefit or hinder supplementary supervision?

Answer:
No comments.

Questions on enforcement

20. To what extent is FICOD effective in ensuring that supervisors can enforce compliance with the ultimate responsible parent entity in a financial conglomerate?

Answer:
No comments.

General question

21. We would like to invite you to make any further comments on FICOD that you may have. Please include examples and evidence where possible.

Answer:
Insurance Europe would like to make the following comments:

- In our opinion, one of the main critical issues is the difference of the sectoral principles, where both capital and risks are treated differently. Thus, the explanatory power of a consolidated view in a financial conglomerate is limited. Insurance Europe agrees that it is necessary to use sectoral rules in a consolidated view because they are suited for the specific sector.

- Insurance Europe believes it would be advisable to limit the interdependencies between the FICOD and other directives. In particular, the use of definitions from the FICOD, such as the "mixed financial holding company" in other directives, such as the CRD IV/CRR and BRRD has unintended consequences, as these frameworks cannot be applied one-on-one to insurance led conglomerates. For instance, the consolidated capital adequacy calculations under CRD IV, whereby a group attracts capital (including subordinated debt) at group level, leads to an inaccurate view of the capital position of the group, because the most important asset of the group (the insurance part) is ignored.
  - In particular, the definition of mixed financial holding company (which included banking-led insurance-led and mixed conglomerates) is usually too generic to be used in other EU directives/EU Regulations (such as CRD IV/CRR and BRRD).

- There is no possibility to include diversification effects of the sectors in the capital adequacy calculation, whereas the sectors are exposed differently to risks. A diversification effect is economically justifiable. The risks and capital requirements respectively of banks, insurance undertakings and investment firms do not materialise in the same degree and at the same time for all sectors. There are compensatory effects between the sectors. Therefore, diversification effects should be allowed when the capital adequacy is calculated in a conglomerate.